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No. 95-808

In The

Supreme Court of the United States

October Term, 1995

SOUTHEASTERN EXPRESS CO., ET AL.,

Petitioners,

vs.

TRIAD SYSTEMS CORPORATION,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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10 pp

COUNTER-STATEMENT OF QUESTION PRESENTED

The sole question presented is whether a computer service provider that routinely copies highly creative computer service software in its entirety, without the copyright holder's authorization, for commercial purposes, thereby depriving the copyright holder of potential license revenues, commits copyright infringement or instead can successfully invoke the Copyright Act's fair use defense, 17 U.S.C. § 107. Neither of the other two questions raised in the petition was raised in the Court of Appeals, and therefore neither is properly presented to this Court.

PARTIES TO THE PROCEEDING

Respondent Triad Systems Corporation is a California Corporation. Petitioners are properly identified in the petition for writ of *certiorari*.

RULE 29.1 LISTING

Pursuant to Rule 29.1, respondent Triad Systems Corporation discloses that it has no subsidiary or affiliate that has issued shares to the public.

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RESPONDENT'S BRIEF IN OPPOSITION

Respondent Triad Systems Corporation ("Triad") opposes the petition for writ of *certiorari* ("petition") filed by Southeastern Express Company, George Barnes, Gerry Wambolt, and Kevin Clark (collectively, "Southeastern") to review the judgment of the United States Court of Appeals for the Ninth Circuit.

OPINIONS BELOW, JURISDICTION, AND STATUTORY PROVISIONS INVOLVED

The petition properly identifies the opi ions below, the basis for jurisdiction in the District Court and the Court of Appeals, and Southeastern's stated basis for invoking this Court's jurisdiction. The petition also sets forth the pertinent provisions of the relevant statute, the Copyright Act, 17 U.S.C. § 101 *et seq.*

INTRODUCTION

Southeastern wants to provide computer maintenance services in competition with Triad, which developed its own specialized computer system, complete with copyrighted software. Some of Triad's software was developed specifically to facilitate computer maintenance: "service software." Southeastern could license the service software from Triad, but won't, because Southeastern says it is "philosophically" opposed to paying license fees to a competitor. Southeastern has not even explored whether it could write its own software or hire someone to do so.

So Southeastern resorts to larceny. Without Triad's permission, Southeastern uses, and in the process copies, service software owned by Triad, licensed to mutual customers of Triad and Southeastern, and resident on the customers' computers. After a jury unanimously (and quickly) found this to be copyright infringement, the District Court issued a preliminary injunction. The Ninth Circuit affirmed.

Southeastern says this unexceptional outcome is worthy of Supreme Court review because the case presents three important copyright issues. That is false. Two of the three questions Southeastern identifies – whether an electronic copy of a software program is an infringing "copy" under the Copyright Act, and

whether licensees have the rights of "owners" under the Act – are not presented. They are long-settled issues that, probably because they are long-settled, were not argued to the Court of Appeals, which therefore said nothing about them. The third question, which is whether the "fair use" doctrine excuses Southeastern's deliberate appropriation of Triad's copyrighted service software – *not*, as Southeastern states, inadvertent copying of Triad's operating system software – was argued below. But Southeastern does not claim the lower courts' decisions rejecting the fair use defense are in conflict with any other copyright case, and they are not. The conflict Southeastern does assert, with an antitrust decision of this Court addressing no copyright issues whatever, is contrived.

There is, accordingly, nothing about this case worthy of review. The limited resources of this Court are hardly needed to determine whether a district court judge can preliminarily enjoin one service company from continuing to steal the copyrighted service software of another pending resolution of all remaining issues in the case. The petition for writ of *certiorari* should be denied.

COUNTER-STATEMENT OF THE CASE

Triad

Triad is a computer manufacturer and software developer based in Livermore, California. It makes computer systems for the automotive aftermarket, *e.g.*, auto parts wholesalers and retailers ("jobbers"). Triad has always marketed turnkey computer solutions – everything its customers need to operate and get maximum benefits from their Triad computers. SR138-144.[1] That includes hardware, industry-specific inventory management and financial

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[1] Record citations are to Southeastern's petition ("Pet."), the appendix to it ("Pet. App."), the clerk's record below ("CR"), Southeastern's excerpt of record filed with the Ninth Circuit ("ER"), and Triad's supplemental excerpt of record filed with the Ninth Circuit ("SR"). The Ninth Circuit's decision appears at Pet. App. 1-22, the District Court's Order of Preliminary Injunction ("Injunction") appears at Pet. App. 23-31, and the District Court's Findings of Fact Regarding Fair Use appear at Pet. App. 32-38

software, information services products such as automated price updating, and post-sale service and training.

This case concerns a family of Triad computers introduced in 1984, known as the Series 12. SR139. Triad developed and copyrighted three different types of software for the Series 12: operating system software, applications, and service utilities. Pet. App. 4. Triad's service software is at the heart of this case.[2]

Triad developed nearly 200 service software programs to help maintain the Series 12. Principal among these are data file "maintenance" programs (SR139), a communications program called REST that allows systems to be serviced remotely (SR157, ER219, ER241, SR169, 197-202), and various diagnostic programs, which tell technicians what's wrong with a system's software or hardware. SR168-170, ER241-244; *see also* Pet. App. 35 ¶ 10.

When Triad delivers a system to a customer, it delivers software tapes that contain the operating system software and substantially all of the service utilities. The operating system must be available to the customer because it is "necessary to run any other program on the computer" (Pet. App. 4), including the applications programs customers pay to use. The service utilities, on the other hand, are on the tapes so that Triad's service technicians can use them, either on site or remotely through the REST link, without interrupting customers' use of their computers. ER241, SR169, 197-202. Customers are also licensed to use the utilities, but virtually all hire someone else, Triad or Southeastern, to do so. SR208-209.

This case is not about Southeastern's arguably inadvertent use of Triad's operating system software in the course of turning on its customers' computers, though Southeastern likes to say that. *See, e.g.*, Pet. at 2, 13. It is about Southeastern's deliberate use of Triad's service software to repair and maintain its customers' computers.

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[2] It is undisputed that Southeastern also uses, and in doing so copies, Triad's operating system software, primarily by turning on its customers' computers. Pet. App. 5. The Injunction expressly allows Southeastern to do this. Pet. App. 29-30 ¶ 3.

Southeastern and Its Use of Triad Service Software

Southeastern is an independent service organization ("ISO") based in Macon, Georgia. It was formed in 1989 by a former Triad salesman, petitioner George Barnes; in 1991, Barnes was joined by two other former Triad employees, petitioners Gerry Wambolt and Kevin Clark. ER263. Southeastern has three businesses: (1) it provides computer repair services to Series 12 owners; (2) it buys and resells used Series 12 systems with Triad software on them; and (3) it develops and markets its own software and information services products for the Series 12 system. Only Southeastern's service business is at issue here. Pet. App. 4 n.2.

Southeastern has over 350 service customers under contract. It attracts them by promising them "the best for less," *i.e.*, all the benefits of Triad's highly valued software programs without Triad's standard fees. SR441-443. Like Triad, Southeastern sells service contracts in which it agrees to provide, for a fixed monthly fee, whatever hardware service, advice line service ("how to" telephone support) and software support (the services made possible by Triad's utilities) its customers may need. SR204; *see also* Pet. App. 23 ¶1 (Judge Smith found Southeastern's service "contracts give Southeastern an incentive to use Triad's utility software programs"). These contracts are, as Southeastern's witnesses put it, in the nature of insurance policies; no matter what malfunctions, Southeastern is obligated to repair it. SR203-204. Southeastern's service contract fees average about $250 per month. SR302.

Customers demand complete service for that kind of money – a reasonable expectation, given that Southeastern's advertising and customer solicitations promise "complete repair service." SR440, SR205-209. That promise is critical: Southeastern's trial witnesses testified that Southeastern could not successfully market its service agreements without offering to provide "complete repair service," including software support. SR225-227.

Since Southeastern has not developed its own service utilities, it provides software support by using Triad's.[3] There is no question

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[3] Southeastern complains that it is unable to write its own utilities. Pet. at 3-4. But competent evidence of this has never been produced, and the record establishes

about this. All of Southeastern's trial witnesses admitted that it was company policy to use, and in the course of using copy, Triad's service software, without restriction, whenever necessary to repair or maintain customers' computers. SR224, SR260-262, SR327-328, SR337-338, ER337 (showing that Southeastern customers received utility service). Accordingly, Judge Smith found that Southeastern "does not limit its use of Triad's software to just turning on the Triad computer such that the operating system is copied into RAM [random access memory]," but rather "goes beyond that" and copies "whatever Triad software Southeastern deems necessary to service its customers' Triad systems." Pet. App. 36 ¶ 13. The Ninth Circuit reached a similar conclusion. Pet. App. 5, 14.

Indeed, Southeastern's service business is built on this sort of copying. Judge Smith observed that "witnesses for both parties testified at trial that use of Triad's service software is essential for an independent service provider like Southeastern to remain in the business of providing service contracts on Triad systems." Pet. App. 37 ¶ 17. Southeastern's disingenuous claim that it "sells only its labor, experience, and skill" (Pet. at 22) ignores the importance of Triad's service software. Without it, Southeastern could not be in the service business.

Southeastern's use of Triad's service software is larceny: Southeastern does not have the tools to perform software maintenance itself; Triad does; Southeastern won't pay Triad to use its tools; and instead Southeastern just takes them when it feels the need. That is what the case is about.

Southeastern Does Not Use Its Customers' Software; It Uses Triad's

Southeastern claims the Injunction prevents it from using its customers' software in the course of maintaining their computers. Pet. at 8-9, 17-18, 23-24. That is false.

Since 1985, Triad has marketed its computer systems under combination sales and licensing agreements whereby the customer buys, and thereafter owns, the computer hardware, but merely

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that Southeastern has never tried to develop any utilities. It chose instead to use Triad's. SR236-238, SR327-336.

licenses the software. SR147-149, SR447-448. Judge Smith found that under these agreements:

> Triad owns its software and the customer acquires a restricted right to use the software. The license allows only the Triad customer itself or its direct employees to use or distribute the software described in the license. The license prohibits the customer from allowing others . . . to use it.

Pet. App. 34 ¶ 4. The Ninth Circuit made the same finding. Pet. App. 5.

Triad's software licensing terms are standard. Similar language can be found in treatises on software agreements, as well as case law discussing other companies' licenses. *See, e.g.*, Robert P. Bigelow, *Computer Contracts: Negotiating and Drafting Guide* (1987) Form 8.06[2] at pp. 8-62-8-63 (Rel. 12/11/93); L.J. Kutten, *Computer Software: Protection Liability Law Forms* (1987) § 8.02[2][g][ii]; *MAI Sys. Corp. v. Peak Computer, Inc.*, 991 F.2d 511, 517 n.3 (9th Cir. 1993), *cert. dismissed*, 114 S.Ct. 671 (1994).

Years ago, Judge Smith expressly held that Southeastern may freely use customer-owned software, *i.e.*, software obtained under the sales agreements Triad used until 1985. SR3-44. The Injunction is consistent with that holding; it only prohibits Southeastern from using Triad-owned software licensed to customers under Triad's post-1985 agreements. Pet. App. 24-30 ¶¶ 1(a), 1(c), 2-3. The Ninth Circuit agreed with Judge Smith's interpretation of Triad's agreements and found that the Injunction struck the proper balance between Southeastern's right to perform service for customers who purchased their software from Triad, and its corresponding duty to refrain from providing service to customers who licensed Triad-owned software. Pet. App. 4-5, 16.[4]

Southeastern's Refusal to Obtain its Own License

Southeastern says that Triad is trying to monopolize the service business by preventing Southeastern from using service

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[4] Southeastern pays no attention to these different agreements in any event. Its witnesses admitted at trial that they make no effort to determine whether a potential customer has purchased or licensed its software before agreeing to provide service. SR222-223.

utilities. Pet. at 23. In fact, Triad has been willing to license Southeastern. Southeastern just refuses to consider it.

Triad did not offer Southeastern a license before filing suit. Confronted with a broad pattern of copyright infringement, Triad immediately pursued its legal and equitable remedies.[5] Triad has no obligation to offer Southeastern a license,[6] but has been willing to license Southeastern for a mutually agreeable royalty. SR153-153.1, ER157-158 (regarding a specific license offer made). The problem is that Southeastern won't pay anything because of its "philosophy." Here is how Southeastern's Vice President testified:

> Q. Have you ever asked Triad to license you that software?
>
> A. No, I haven't.
>
> Q. Is there a price that you'd be willing to pay?
>
> A. I don't think I would be willing to pay a price to use – to go in – to be competing with what would become my vendor, at that point in time, which would be Triad Systems. And I think that it's extremely objectionable . . . . That would be my position.
>
> * * *
>
> Q. Putting that aside for the moment, has there ever been an occasion in which Southeastern has tried to determine whether it could afford to pay a software license to Triad?
>
> A. No, I don't think so because of the philosophical objection.
>
> Q. Okay.
>
> A. There are certain things that I will not consider doing in life, because of personal conviction.

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[5] This bothered Judge Smith, who said that Triad could have "handled [the matter] a little more tactfully." ER406. But, she noted, "good manners is not [the] issue." *Id.*

[6] *See Data General Corp. v. Grumman Systems Support Corp.*, 36 F.3d 1147, 1187-89 (1st Cir. 1994); *Service & Training, Inc. v. Data General Corp.*, 963 F.2d 680, 686 (4th Cir. 1992); *Advanced Computer Servs., Inc. v. MAI Sys. Corp.*, 845 F. Supp. 356, 370 (E.D. Va. 1994).

SR228-230. Southeastern's President shares this philosophy. SR231, SR259-261 ("I can't in my wildest dreams imagine having to pay a fee to Triad or anybody else for going out and helping a customer fix his computer with software that he rightfully has").[7] It is this philosophy, in fact, that leads Southeastern to simply take the software it could license but won't pay for.

Southeastern's Persistent Claim That This Case is About Automatic Copies of the Operating System Made in RAM

Southeastern constantly tries to muddle its deliberate copying of Triad's service software with the copying of the operating system into RAM that occurs automatically whenever Southeastern turns on a customer's computer. Its latest tactic is to incorrectly construe the term "operating software" used in Triad's license agreements as proof that the service software and the operating system are the same. Pet. at 3. In reality, they are quite different: Operating system software organizes and controls access to the hardware, acting as a computer's internal "traffic cop." SR155. It is in constant use. Service software, on the other hand, maintains, diagnoses, and repairs the hardware and the software on command, like an automated computer technician. SR155-156.1. It is accessed specifically to perform service. Judge Smith and the Ninth Circuit both recognized this distinction, which is fundamental to their decisions. Pet. App. 4, 25 ¶ 1(d)(i)-(iii). Regrettably, both first had to fight through the same disinformation presented to this Court.

The District Court

Southeastern first made this misrepresentation years ago, in connection with one of Triad's pre-trial motions for a

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[7] In its petition, Southeastern attacks Triad's characterization of Southeastern's philosophy as akin to that of a tax protester, and calls Triad's offer "a ploy." Pet. at 8 n.4, 19 n.12. In doing so, however, Southeastern confirms that it would not under any circumstances entertain an offer to license, ploy or not, and once again gives reasons for its admittedly "steadfast" refusal that are, at best, "philosophical." *Id.*

preliminary injunction. At a hearing in December, 1993, Judge Smith indicated her willingness to consider the viability of Southeastern's fair use defense, provided that "the software that is used or becomes part of the operation when the servicing is done is the operating system software," and not the diagnostics or other utilities. SR54-56. This was a false premise, since Southeastern routinely uses the diagnostic and utility software to perform service. SR158, ER222, SR161-165, ER240. But rather than telling Judge Smith that, Southeastern told a great untruth, that "operating software is the key" for Southeastern's business. Southeastern even conceded that Triad should be paid for Southeastern's use of Triad's service software, telling Judge Smith:

> MR. KATZ [Southeastern's counsel]: . . . And I absolutely agree with you. *If we copy their [Triad's] diagnostic software for the purpose for which it's intended, they deserve a royalty on that.*
>
> THE COURT: Absolutely.
>
> MR. KATZ: No question about it.

SR54-57 (emphasis supplied).

The misrepresentation had its intended effect: On March 18, 1994, Judge Smith issued a 53-page decision denying Triad's motion on the ground that merely copying operating system software might be a fair use. ER65-117. The decision shows that Southeastern had succeeded in convincing Judge Smith that Southeastern's use of the operating system software required merely to "turn on the computer" was "the key."

Triad's copyright claims were tried to a jury between January 12 and February 3, 1995.[8] In that forum, Triad proved, and Southeastern's witnesses admitted, that Southeastern used Triad's copyrighted service software without limitation. *That* –

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[8] Trial was bifurcated so that Triad's copyright infringement and related unfair competition claims, together with Southeastern's fair use defense, were tried in 1995, and Southeastern's counterclaims are set for trial in June, 1996. The Ninth Circuit found that bifurcation was justified and within Judge Smith's discretion. Pet. App. 17-18.

not turning on computers – was the key. Triad also proved the extent of its investment in the service software, how creative it is, and how Triad obtains its return on that investment through service fees and improved efficiency. SR152-153, SR155-156, SR170-176, ER242. And Triad proved that it had lost hundreds of customers and many hundreds of thousands of dollars of profit on account of Southeastern's unlicensed use of Triad's service software. SR305, ER317.

During trial, Judge Smith directed a verdict on the fair use defense as it pertained to the service software. ER414-417. Central to her decision was her realization that, contrary to Southeastern's representation at the 1993 hearing, Southeastern's intentional use of specialized service software, not the automatic loading of the operating system when the computer is turned on, was the key. Judge Smith explained this when Southeastern argued, again, that this case was "truly unique."

> THE COURT: [L]et me say something about that, Mr. Christopher [Southeastern's counsel]. I thought that was true before this trial, because I really thought that maybe all you did was come in and turn it on. And, you know, [Southeastern's counsel] Mr. Katz, is very – creatively, as a good advocate does, kept pulling that. Well, you know, does anybody charge a license fee to come in and turn it on? [B]ut that's not all you do. You don't just come in and turn it on and then go home. You come in; you turn it on, and then you use the software to do your thing. And so it's not just *MAI*. It's what happens after the computer gets turned on.

ER401-402.

On February 3, 1995, after just three hours of deliberations, the jury returned a verdict for Triad on all three counts of copyright infringement and awarded Triad $738,172 in damages. After trial, Triad moved for a permanent injunction preventing Southeastern from continuing to infringe. Even then, Southeastern once again told Judge Smith "we were just out there turning on the computers, you know." CR414 at 19.

Judge Smith made it clear that she knew better, stating that "*it's clear to me that that's not all they do, you know . . .* And I would suggest that, if the evidence had showed that was all they do, my decision on fair use would likely have been quite different. *But that was not what the evidence showed.*" *Id.* at 22-23 (emphasis added). Accordingly, Judge Smith issued the Injunction.[9] It was, the Ninth Circuit noted, "a long step forward for Triad." Pet. App. 7.[10]

The Ninth Circuit

Southeastern tried the same disinformation strategy with the Ninth Circuit. Petitioning for a stay of the Injunction pending appeal, it told a motions panel that this was a "turn-on-the-computer-and-go-to-jail" case.[11] Southeastern's misrepresentations enabled it to obtain a stay. Pet. App. 7. But Southeastern's case once again crumbled on closer inspection.

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[9] The Injunction was not hastily granted. Judge Smith denied all three of Triad's pre-trial preliminary injunction motions in order to give Southeastern "every opportunity to explore" its legal theories. CR364 at 1183. Only after that exploration turned out to be a farce, and the jury found for Triad, did she enjoin Southeastern, and even then only temporarily, rather than permanently, as Triad had requested. That is far more extensive due process than parties opposing injunction motions normally enjoy, the Ninth Circuit found, and yet another indication Judge Smith acted within her discretion. Pet. App. 17.

[10] Southeastern never discusses the Injunction or the applicable scope of this Court's review. That is not surprising, considering the deference Judge Smith's decision must be given. The Ninth Circuit correctly applied the rule that an order granting a preliminary injunction is "subject to limited review," to be reversed only for an abuse of discretion or application of an erroneous legal standard or clearly erroneous findings of fact. Pet. App. 8. Further disfavoring Southeastern's petition is this Court's usual practice to "await final judgment in the lower courts before exercising [ ] *certiorari* jurisdiction." *Virginia Military Inst. v. U.S.*, 113 S.Ct. 2431, 2432 (1993) (Scalia, J. concurring) (denying *certiorari* for case on remand to district court). The interlocutory nature of Southeastern's petition "itself alone" is sufficient reason to deny it. *Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916) (same).

[11] The complete transcript by a certified court reporter of the oral argument before the Ninth Circuit motions panel was submitted to Justice O'Connor with Triad's brief in opposition to Southeastern's application for a stay pending *certiorari*.

The Ninth Circuit merits panel unanimously affirmed the grant of the Injunction based on its findings that Triad was likely to succeed on the merits of its copyright claims and that Triad had shown a likelihood of irreparable harm. Pet. App. 9-11. The court rejected Southeastern's numerous counter-arguments and defenses, including fair use, copyright misuse,[12] claimed errors in the conduct of trial, and the alleged overbreadth of the Injunction, but, significantly, *not* including the first two issues in Southeastern's petition: RAM copying and Section 117. *Id.* Southeastern's petition for rehearing was denied, its suggestion for rehearing *en banc* was rejected, and the stay pending appeal was lifted.

Southeastern's Previous Application to This Court

Southeastern then asked Justice O'Connor to stay the Injunction pending *certiorari*. And Southeastern told Justice O'Connor, as it had told Judge Smith and the Ninth Circuit, that "the principal question raised by this case" was whether Southeastern and other ISOs could "operate their clients' computers during the course of their work (thereby loading the client's software into RAM)." Stay Application (dated October 18, 1995) at 2-3. No mention was made of Southeastern's deliberate, extensive use of Triad's service software to perform the service routines for which Triad created it. On October 20, 1995, Justice O'Connor issued a temporary stay, but on October 26, 1995, the day after Triad filed its opposition, she vacated the stay and denied Southeastern's application "in all respects." Order (dated October 26, 1995) at 1.

We have retold this history because the Court needs to understand that this case is solely about one service company misappropriating its competitor's copyrighted service tools, not about some technological trap that leads to pernicious monopolies. When that is understood, it is a very easy case.

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[12] Judge Smith granted Triad summary judgment on Southeastern's copyright misuse defense on June 8, 1995, and the Ninth Circuit agreed with that ruling. Pet. App. 15.

REASONS WHY THE WRIT SHOULD BE DENIED

I. THE COURT OF APPEALS DID NOT CONSIDER, LET ALONE DECIDE IN A WAY THAT CONFLICTS WITH OTHER CIRCUITS, WHETHER LOADING A SOFTWARE PROGRAM INTO RAM CREATES A "COPY" OF THE PROGRAM UNDER THE COPYRIGHT ACT.

A. The Issue of Whether RAM Copying is Infringement Was Not Addressed Below.

It is apparent from Southeastern's petition that it really wants the Court to review *MAI Systems Corp. v. Peak Computer*, 991 F.2d 511 (9th Cir. 1993), *cert. dismissed*, 114 S.Ct. 671 (1994), in which the Ninth Circuit held that loading a software program into a computer's RAM creates a "copy" of the program under the Copyright Act. Southeastern devotes four pages to *MAI*, which it claims escaped review because it was settled. *See* Pet. at 10 n.6, 14 n.9. Southeastern says the Court can review *MAI* here because the decision below was "grounded" on *MAI*, which Southeastern "challenged." *Id.* But that's not true.

Southeastern did not challenge *MAI* below, as an exchange between the Ninth Circuit panel and Southeastern's counsel during oral argument shows:

> THE COURT: How do you deal with the *MAI*?
>
> MR. KATZ [Southeastern's Counsel]: Well *MAI* – we can live with *MAI*. *MAI* is an incomplete case because it does not do the fair-use analysis.

App. 1 at 19.[13]

The truth is that Southeastern complained to Judge Smith about *MAI*, and once said it would ask the Ninth Circuit to reconsider its holding regarding RAM copying. But then

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[13] In its petition, Southeastern quotes only the Ninth Circuit's part of this exchange and claims that it shows *MAI* was challenged below. Pet. at 13. To avoid further misrepresentations of this type, attached to this brief is a complete transcript by a certified court reporter of the Ninth Circuit's official recording of the oral argument (cited here as "App.").

Southeastern chose not to do so when it appealed the issuance of the Injunction. Consequently, there is no mention of this argument in Southeastern's Ninth Circuit briefs, which were styled as raising other issues, supposedly arising "in the wake of" *MAI*, principally fair use. Ninth Circuit Opening Br. at 2; Ninth Circuit Reply Br. at 1.

Southeastern is thus raising here an argument it declined to raise before the Court of Appeals. That is improper. *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 39 (1989) (absent exceptional circumstances, new arguments may not be raised before this Court); *California v. Taylor*, 353 U.S. 553, 557 n.2 (1957) (argument made in district court but not in court of appeals was waived); *see also* Robert L. Stern *et al., Supreme Court Practice* 342-43 (7th ed. 1993) ("The Court does not sit to resolve issues that might have been but were not raised below").[14] On this ground alone the petition should be denied.

B. There is No Conflict Over Whether Copying Software into RAM is Copyright Infringement.

Even if Southeastern could now belatedly challenge *MAI*, there would be no reason to overturn it. The decision is not the aberration Southeastern claims it is. The proposition that RAM copies qualify as "copies" under the Copyright Act is at least ten years old, and has never been rejected by any court, to

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[14] *See also EEOC v. FLRA*, 476 U.S. 19, 24 (1986) (dismissing writ as improvidently granted because question presented was not raised on appeal: the Court's "normal practice . . . is to refrain from addressing issues not raised in the Court of Appeals"); *United States v. Alvarez-Sanchez*, 114 S. Ct. 1599, 1605 n.5 (1994) (finding no exceptional circumstances to warrant review of claim waived below); *Price Waterhouse v. Hopkins*, 490 U.S. 228, 240 n.5 (1989) (refusing to address argument not made on appeal); *Oneida County v. Oneida Indian Nation*, 470 U.S. 226, 245 (1985) (refusing to reach claim raised at trial but not on appeal). The sole case Southeastern relies on in its effort to get the Court to depart from its normal practice, *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1099 n.8 (1991), is distinguishable, as it involved litigated issues " 'in a state of evolving definition and uncertainty' " and "important to the administration of federal law," not routine matters conceded below.

Triad's knowledge. *See, e.g., NLFC Inc. v. Devcom Mid-America, Inc.*, 45 F.3d 231, 235 (7th Cir.), *cert. denied*, 115 S.Ct. 2249 (1995) ("Neither party disputes that loading software into a computer constitutes the creation of a copy under the Copyright Act"); *Vault Corp. v. Quaid Software, Ltd.*, 847 F.2d 255, 260 (5th Cir. 1988) ("the act of loading a program from a medium of storage into a computer's memory constitutes a copy of the program"); A*pple Computer, Inc. v. Formula International, Inc.*, 562 F. Supp. 775 (C.D. Cal. 1983) (copying from a diskette into RAM memory is a copy), *aff'd*, 725 F.2d 521 (9th Cir. 1984); *Advanced Computer*, 845 F. Supp. at 364 & n.9 (collecting cases and noting no contrary authority); *see also* Information Infrastructure Task Force, *Intellectual Property and the National Information Infrastructure: Report of the Working Group on Intellectual Property Issues* 66 n. 204 (1995) (noting that *MAI*'s "holding that booting a PC involves copying the operating system seems quite unexceptional"). It is no wonder Southeastern does not even claim there is a conflict among the circuits on this issue, or any other ground for review found in Rule 10.

Did all the courts get this issue wrong? Of course not. When Congress enacted the Computer Software Copyright Act of 1980, it substantially adopted the findings and recommendations of CONTU, the National Commission on New Technological Uses of Copyrighted Works, established in 1974.[15] CONTU recognized that under the Copyright Act of 1976, using a software program, which entailed copying it into RAM, "is the preparation of a copy and, therefore, a potential infringement of copyright."[16] It is precisely because of that recognition that CONTU recommended amending Section 117 of the Copyright Act, 17 U.S.C. § 117, to permit limited electronic copying of software programs. CONTU Report at 13; *see also Vault*, 847 F.2d at 260. It makes no sense, then, to think that electronic copies of software programs cannot constitute infringement; if so, Section 117 would be superfluous.

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[15] With one notable exception, relevant to this case. Page 20, below.

[16] Final Report of the National Commission on New Technological Uses of Copyrighted Works (July 31, 1978) ("CONTU Report") at 12. *See also id.* at 22 (copying "into the memory of a computer" is also copying under the law).

The entire thrust of the 1980 Act, moreover, was to ensure that copyright law was technologically up to date, so that software programs would have full copyright protection. CONTU recognized copying software programs was easy, and virtually cost-free. CONTU Report at 10. It further recognized that "[a] computer program may be misappropriated in a variety of ways," and that as technology advanced, more methods of misappropriation would likely arise. *Id.* at 22. CONTU used "copying" as the demarcation line between misappropriation that copyright law could and could not address, *id.*, and Congress followed its lead. So in this case, which involves Southeastern "commandeering" Triad's valuable service software through a process that indisputably involves copying – and a form of copying CONTU explicitly deemed infringement – the policies of the 1980 Act are wholly in Triad's favor.

Southeastern answers all of this with a hyper-technical argument about whether electronic copies are sufficiently "fixed" to satisfy the Copyright Act's definition of a "copy." *See* 17 U.S.C. § 101. But CONTU specifically addressed this: it found that "[b]ecause works in computer storage may be repeatedly reproduced, they are fixed and, therefore, are copies." CONTU Report at 22. It further found that copies made in a computer's memory are fixed, because in memory the program "still exists in a form from which a human-readable version may be produced." *Id.*

The statutory definition of "copies," moreover, excludes only "transitory" reproductions, not all temporary ones. *Id.* The cases addressing this issue have uniformly recognized that, while temporary, "the RAM representation of [a software] program is sufficiently 'fixed' to constitute a 'copy' under the Act." *Advanced Computer,* 845 F. Supp. at 363.[17]

This is not only good legal analysis, it makes sense. As the court in the analogous *Advanced Computer* case recognized,

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[17] The dictum Southeastern quotes from *Apple Computer, Inc. v. Formula Intern., Inc.*, 594 F. Supp. 617, 622 (C.D. Cal. 1984), to the effect that a RAM copy is a "temporary fixation," does not help Southeastern. Pet. at 12. To the contrary, as the Ninth Circuit recognized in *MAI*, it establishes that a RAM copy is sufficiently "fixed" to be a "copy" under the Copyright Act. *MAI*, 991 F.2d at 519.

ISOs like Southeastern do not just come in and turn on the computer for an instant; they copy software into RAM and keep it there for exactly as long as they are using it, thereby appropriating the software's economic value. 845 F. Supp. at 363, 366; *see also* Pet. App. 36 ¶13 (making similar finding about Southeastern). It would make no sense to call that "transitory," unimportant copying. It is copying that deprives the copyright holder of its just reward.

The fact that Southeastern does not merely "turn on" computers is also the complete answer to the law review articles discussing *MAI* that Southeastern cites. Pet. at 5.[18] The articles – which are of course about *MAI*, not this case – criticize *MAI* for supposedly holding that "any time a third party turns on a computer, she is infringing the system software's copyright unless she has purchased a license."[19] That is not the rule of this case, however, because the Injunction expressly permits Southeastern to turn on its customers' computers. Page 6, above. This case involves far more extensive, deliberate infringing activity: Southeastern is "commandeering" Triad's service software "and using it for the very purpose for which, and in precisely the manner in which, it was designed to be used." Pet. App. 14.

Southeastern told the Ninth Circuit it could live with *MAI*. It did not raise the electronic copying issue, and the Ninth Circuit did not rule on it. Nor is the proposition that electronic copying may be infringement controversial, especially when applied to the facts of this case. It should not be considered by this Court.

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[18] Ironically, during oral argument before the Ninth Circuit, Southeastern's counsel said the articles were "unfairly critical" of *MAI*. App. 19. One of the articles Southeastern most frequently cites was written by its own counsel. Bradley J. Nicholson, *The Ghost in the Machine:* MAI Systems Corp. v. Peak Computer, Inc. *and the Problem of Copying in RAM*, 10:1 High Technology Law Journal 147, 165 n.107 (1995). *See* Pet. at 6 n.2, 9, 12.

[19] Katrine Levin, MAI v. Peak: *Should Loading Operating System Software Into RAM Constitute Copyright Infringement?*, 24 Golden Gate L. Rev. 649, 650 (1994) (*cited at* Pet at 6 n.2).

II. THERE IS NO CONFLICT AMONG THE CIRCUITS AS TO WHETHER LICENSEES HAVE THE RIGHTS OF "OWNERS" UNDER THE COPYRIGHT ACT, 17 U.S.C. § 117.

A. The Purported Section 117 Issue Is Not Properly Before This Court.

Section 117 of the Copyright Act, 17 U.S.C. § 117, provides that "it is not infringement for the *owner* of a copy of a computer program" to authorize another to make a copy of that program "as an essential step in the utilization of the computer program" or for "archival purposes." (Emphasis added). Early in the District Court proceedings, Southeastern argued that Section 117 immunized its copying of Triad's service software. In December, 1992, Judge Smith ruled that was partly right, partly wrong: Southeastern could copy software that Triad had *sold* to third parties, but not software under license. Page 6, above. Judge Smith also noted that in *Vault Corp. v. Quaid Software Ltd.*, 847 F.2d 255 (5th Cir. 1988), the Fifth Circuit held that under some circumstances, license terms contrary to Section 117 might not be enforceable. SR19. Southeastern seized on this argument, but lost. In March, 1994, and again in April, 1994, Judge Smith rejected Southeastern's "public policy argument" and ruled that Triad's licenses were enforceable according to their terms and therefore did not give rise to any Section 117 rights. ER70-73, 75, 112, CR273 at 5-6.

At trial, Southeastern complained from time to time that Triad's licenses were "sale-like," but did not press the point seriously. For example, although Southeastern announced its intention to make a directed verdict motion based on *Vault* (CR377 at 2404), it never did. More importantly, Southeastern did not make this argument to the Ninth Circuit. To the contrary, Southeastern's Ninth Circuit briefs acknowledge that Section 117 applies only to "software *owners*" (Ninth Circuit Opening Br. at 18 (emphasis in original)), and stress that Congress has been asked to change that. Ninth Circuit Reply Br. at 8. Moreover, the footnote from Southeastern's Ninth Circuit brief that Southeastern now cites as evidence that it raised this issue below (Pet. at 15 n.10 (*citing* Ninth Circuit Opening Br. at 21-22 n.14)), is the exception that proves

the rule. The footnote uses Section 117 as lateral support for a *different* argument: that Southeastern believed in good faith that its conduct was a fair use.[20]

But in the Ninth Circuit, Southeastern never made the *Vault* argument on which it seeks *certiorari*, or any other argument to the effect that Triad's licensees should have Section 117 rights. That explains why the Ninth Circuit cited Section 117 only in passing (Pet. App. 4 n.3) and did not cite – let alone discuss – *Vault* at all. In fact, Southeastern admitted in its application to Justice O'Connor for a stay of the Injunction that the Ninth Circuit never addressed the "issue over the application of 17 U.S.C. § 117 to the facts of this case." *See* Stay Application (dated October 18, 1995) at 5.

This Court has made it clear many times that it does not consider issues not addressed by the Court whose decision it is reviewing. Page 14, above. One logical reason for this policy is that the Court "lack[s] guidance from the District Court or the Court of Appeals on [ ] issue[s]" which have "not been adequately briefed and argued" below. *Granfinanciera*, 492 U.S. at 38-39. The alleged conflict with *Vault* regarding Section 117 falls squarely into this category. The Ninth Circuit did not reject *Vault;* it was never given the chance. There is, accordingly, nothing for this Court to review.

B. There Is No "Split" Among Circuit Courts As To Section 117's Interpretation.

Southeastern claims there is a "split in the circuits regarding the interpretation of 17 U.S.C. § 117" allegedly created by *Vault*. Pet. at 16. There is no split. To repeat, Judge Smith accepted *Vault*. SR 19. She simply limited the decision to its actual holding, rather than adding what Southeastern tries to wring out of it. And no circuit, including the Fifth Circuit in *Vault*, has ever held that Section 117 applies to genuine licensees of a copy of a computer program.

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[20] This was vintage Southeastern, which threw in cites to Section 117 in support of several other arguments not relevant here. Ninth Circuit Opening Br. at 14, 18, 33-34; Ninth Circuit Reply Br. at 8.

The courts have consistently found the term "owner" in Section 117 to mean what one would think it means: a purchaser, buyer, or title holder – *not* a licensee. *See, e.g., Aymes v. Bonelli,* 47 F.3d 23, 25 (2nd Cir. 1995) (indisputable that plaintiff "sold defendants the computer program and that defendants [were] therefore the rightful owners of the program" for purposes of Section 117); *S.O.S., Inc. v. Payday, Inc.,* 886 F.2d 1081, 1089 n.9 (9th Cir. 1989) (under Section 117, an "owner of a copy of software has certain rights under the Copyright Act which a mere possessor does not").[21] The distinction between an "owner" and a "licensee" is, after all, elementary. One would not expect courts to struggle with the difference, and they have not.

It is especially unlikely that the courts would confuse "owners" and "rightful possessors" (Southeastern's preferred title) in light of Section 117's legislative history. As Southeastern concedes, Congress' 1980 amendments to the Copyright Act adopted CONTU's recommendations for amending Section 117 *with one exception:* Congress replaced "rightful possessor" with "owner." Pet. at 17; *see also Vault,* 847 F.2d at 260-61 & n.11; *Allen-Myland v. International Business Machines Corp.,* 746 F. Supp. 520, 536 (E.D. Pa. 1990). In other words, Congress deliberately rejected language which might have permitted the interpretation of Section 117 Southeastern wants this Court to adopt in favor of language which led inevitably to the decision below.

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[21] *See also CMAX/Cleveland, Inc. v. UCR, Inc.,* 804 F. Supp. 337, 356 (M.D. Ga. 1992) (rejecting defendants' Section 117 defense because they only leased and did not own a copy of plaintiff's software); *Advanced Computer,* 845 F. Supp. at 367 (rejecting Section 117 defense because it only permits "owners" of a computer program to make or authorize the making of copies; licensees are not owners of the software and possess only the rights in their license agreements); *Synergistic Technologies v. IDB Mobile Communic.,* 871 F. Supp. 24, 29 (D.D.C. 1994) (defendant owned a copy of plaintiff's software because "title to . . . a copy of the software passed to [the defendant] at the time of delivery"); *Micro-Sparc, Inc. v. Amtype Corp.,* 592 F. Supp. 33, 34 (D.C. Mass. 1984) (purchaser of a computer program was the "owner" of a copy); *Hubco Data Products Corp. v. Management Assistance, Inc.,* 219 U.S.P.Q. 450, 456 (D.C. Idaho 1983) (Section 117 defense did not apply because alleged infringer was not the owner of the copy of the software).

Southeastern apparently thinks that because Congress did not explain itself, the substitution of "owner" for "rightful possessor" should be ignored.[22] But the substitution was self-explanatory; the terms, and the difference between them, are plain. *See F.D.I.C. v. Meyer*, 114 S.Ct. 996, 1001 (1994) (an undefined statutory term is given its "ordinary or natural meaning"); *Rake v. Wade*, 113 S.Ct. 2187, 2191 (1993) (when statutory language is clear, it should be enforced according to its terms). Indeed, the Fifth Circuit in *Vault*, the case Southeastern says is in conflict with the decisions below, recognized the difference: it noted without controversy that Section 117 "grants 'owners,' *as opposed to 'rightful possessors*,' " limited copying and adaptation privileges. *Vault*, 847 F.2d at 260 n.11 (emphasis added).

Southeastern's attempt to create a conflict with *Vault* is based on the fact, true enough, that the Fifth Circuit attributed Section 117 rights to a party who had ostensibly licensed the subject software. However, the court was dealing with a "shrink-wrap" license[23] which the district court below had found to be unenforceable. *Vault Corp. v. Quaid Software, Ltd.*, 655 F. Supp. 750, 761-63 (E.D. La. 1987). In any event, *Vault* does not hold what Southeastern says it holds.

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[22] Southeastern argues it would "contravene[ ] precedent set by this Court" not to adopt its Section 117 interpretation, relying on *Straus v. Victor Talking Machine Co.*, 243 U.S. 490 (1917), and *Boston Store of Chicago v. American Graphophone Co.*, 246 U.S. 8 (1918). Pet. at 18 & n.11. Southeastern's reliance is misplaced. Both cases involved unlawful attempts by patent holders to fix the retail price of their patented inventions. Neither involved copyright law, software, or most importantly, the interpretation of a specific statute in a way that contradicts Congress' selection of statutory language. The cases are wholly inapplicable here.

[23] The term "shrink-wrap" refers to the plastic wrapping on a software package through which buyers can read the license agreement. Shrink-wrap licenses are typically used for mass-marketed consumer software. They are structured so that, by opening the plastic wrap and using the software, consumers automatically bind themselves to the terms of the license. Shrink-wrap licenses are often held to be adhesion contracts and unenforceable against consumers. *See* Michael D. Scott, *Scott on Computer Law* § 12.08[D] at 12-17 to 12-20 (2d ed. 1995). Triad's licenses involved here are not shrink-wrap licenses. SR445-51.

Vault Corporation, which made "copy protection" diskettes and software, sued Quaid, which had obtained a copy of Vault's software, copied it, and developed its own software program to defeat Vault's copy protection function. *Id.* at 256-58. Quaid argued its copying was permitted under Section 117 since its copy was "created as an essential step in the utilization" of Vault's program. Vault disagreed, arguing that Section 117 did not apply because it only permits copying of the software for its "intended purpose." *Id.* at 259-61. The court sided with Quaid, and that is the entirety of the Section 117 holding. The Fifth Circuit, in discussing Section 117, did not even raise, much less attach significance to, Vault's software's shrink-wrap license, probably because the district court below had found the license unenforceable.[24] Nor does the case hold, as Southeastern suggests, that Section 117 overrides genuine, enforceable license agreements, like Triad's.[25] Rather, *Vault* has the

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[24] The district court in *Vault* held that the Copyright Act preempted the Louisiana state law upon which the shrink-wrap license was based, and that the license was therefore an unenforceable adhesion contract. *Vault*, 655 F. Supp. at 761-63. The Fifth Circuit affirmed. *Vault*, 847 F.2d at 268-70. It is no wonder, then, that the Fifth Circuit ignored the existence of the license in discussing Section 117.

[25] No court, to Triad's knowledge, has cited *Vault* for the proposition that Section 117 applies to licensees. *See Aymes*, 47 F.3d at 26 (citing *Vault* to show that Section 117 follows CONTU's recommendations); *Allen-Myland*, 746 F. Supp. at 536 (citing *Vault* to show that Congress adopted CONTU's recommendations, with single change of "rightful possessor" to "owner"); *Foresight Resources Corp. v. Pfortmiller*, 719 F. Supp. 1006, 1009-10 (D. Kan. 1989) (citing *Vault* to show that courts rely on the CONTU report to interpret Section 117); *Sega*, 977 F.2d at 1520 n.6 (citing *Vault* for the proposition that "authorization of section 117(1) [is] not limited to use intended by [the] copyright owner"); *NLFC*, 45 F.3d at 234-35 (citing *Vault* for general copyright law and to show that "loading a program from a medium of storage into a computer's memory creates a copy of the program"); *MAI*, 991 F.2d at 519 (same); *In Re Independent Service Organizations Antitrust Litigation*, 1995 WL 769164 at *3 (D. Kan. Dec. 11, 1995) (same); *CentralPoint Software, Inc. v. Nugent*, 903 F. Supp. 1057, 1059-60 (E.D. Tex. 1995) (same); *Advanced Computer*, 845 F. Supp. at 364 n.9 (same); *Sega Enterprises Ltd. v. Accolade, Inc.*, 785 F. Supp. 1392, 1399 (N.D. Cal.) (same), *aff'd*, 977 F.2d 1510 (9th Cir. 1992); *Kepner-Tregoe, Inc. v. Leadership Software, Inc.*, 12 F.3d 527, 538 n.24 (5th Cir. 1994) (citing *Vault* for the rule that "the Copyright Act preempts all legal and equitable rights that fall within the scope of copyright law."), *cert. denied*, 115 S.Ct. 82

meaning for which Judge Smith cited it: in some circumstances, transactions labeled licenses can be sales in substance.[26] Southeastern simply failed to prove that Triad's licenses were in that category and chose not to appeal the resulting ruling.

Neither the Ninth Circuit's decision in this case nor the supposedly conflicting Fifth Circuit decision in *Vault* addresses the Section 117 "issue" cited in Southeastern's *certiorari* petition. Moreover, the District Court in this case correctly interpreted *Vault*.[27] Thus, there is perfect harmony on the Section 117 "issue," and certainly not a conflict that warrants *certiorari* review. *See Lawson v. Murrey*, 115 S.Ct. 2264, 2267 (1995) (Scalia, J., concurring) (*certiorari* denied where case presented "no clear conflict with the decisions of the other courts"); *Layne & Bowler Corp. v. Western Well Works, Inc.*, 261 U.S. 387, 393 (1923) (grant of *certiorari* requires conflict that is "real and embarrassing").

There is, however, a live controversy over whether "rightful possessors" should have Section 117 rights – in Congress, where it belongs. On January 17, 1995, H.R. 533 was introduced. It would amend Section 117 by striking the term "owner" and inserting "rightful possessor." ER586. Perhaps the proponent of the

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(1994); *Value Group, Inc. v. Mendham Lakes Estates, L.P.*, 800 F. Supp. 1228, 1233 (D.N.J. 1992) (citing *Vault* for copyright law on derivative works); *Micro Consulting, Inc. v. Zubeldia*, 813 F. Supp. 1514, 1531 (W.D. Okl. 1990) (same), *aff'd*, 959 F.2d 245 (10th Cir. 1992); *Travelers Health Network v. Orleans Parish Sch. Bd.*, 842 F. Supp. 236, 239 (E.D. La. 1994) (citing *Vault* for preliminary injunction standard); *Shell Oil Co. v. Zewe*, 805 F. Supp. 394, 396 (E.D. La. 1992) (same); *Compaq Computer Corp. v. Procom Technology, Inc.*, 1995 WL 728372 at *13 (D. Idaho Oct. 6, 1995) (citing *Vault* for general copyright law).

[26] Indeed, *Vault* is well-known for its handling of the "Shrink-wrap" license enforceability issue. *See* Page M. Kaufman, Note, *The Enforceability of State "Shrink-wrap" License Statutes In Light Of Vault Corp. v. Quaid Software, Ltd.*, 77 Cornell L. Rev. 222 (1988); Mark A. Lemley, *Intellectual Property And Shrink-wrap Licenses*, 68 S. Cal. L. Rev. 1239, 1256 (1995); Michael D. Scott, *Scott on Computer Law* § 12.08[D] at 12-22 (2d ed. 1995); Michael A. Epstein, *Modern Intellectual Property* § 10.02[A][2] at 10-87 to 10-91 (3d ed. 1995).

[27] Since *Vault* did not address the Section 117 argument in Southeastern's petition, there is likewise no conflict between *Vault* and *MAI*.

legislation will convince Congress that licensees should have the rights of owners; perhaps not. But either way, Congress, not this Court, is the proper forum for Southeastern to seek changes in a clearly worded, consistently interpreted statute. *See Harper v. Virginia Dept. of Taxation,* 113 S.Ct. 2510, 2522 (1993) (Scalia, J., concurring) (criticizing "judicial lawmaking"); *Florida v. Wells,* 495 U.S. 1, 13 (1989) (Stevens, J., concurring) (same).

III. THE FINDING THAT SOUTHEASTERN'S COMMERCIAL EXPLOITATION OF TRIAD'S SERVICE SOFTWARE IS NOT A "FAIR USE" DOES NOT CONFLICT WITH THIS COURT'S *KODAK* DECISION.

In the District Court and at the Ninth Circuit, Southeastern's flagship argument was that its copying of Triad's service software was a fair use under the Copyright Act, 17 U.S.C. § 107. Page 13, above. Specifically, Southeastern claimed fair use under a broad "promotion of competition" principle it discerned from another Ninth Circuit decision, *Sega Enterprises Ltd. v. Accolade, Inc.*, 977 F.2d 1510 (9th Cir. 1992). The Ninth Circuit rejected the comparison with *Sega*, holding correctly that "*Sega* . . . was a very different case" involving independently creative reverse engineering activities "wholly unlike" Southeastern's wholesale appropriation of Triad's service software. Pet. App. 12-14.

Sega is not even cited in Southeastern's petition, an apparent recognition that this Court would not review whether the Ninth Circuit properly harmonized its own decisions. Nor does Southeastern claim there is a conflict between the Ninth Circuit's decision and any other court's. That is because there is no conflict; in fact, the only other decision on point (and it is on all fours) came to the same conclusion as the Ninth Circuit, and was cited by the Ninth Circuit. *See Advanced Computer,* 845 F. Supp at 366 (computer ISO's use of manufacturer's software to perform service was not a fair use).

Instead, Southeastern presents this Court with a new and different fair use argument: that the Ninth Circuit's decision conflicts with the Court's treatment of antitrust issues in

Eastman Kodak Co. v. Image Tech. Servs., Inc., 504 U.S. 451 (1992). That is grasping at straws. *Kodak* says nothing about copyright law, let alone about fair use. The supposed conflict with the decision below is contrived and senseless.

This Court has addressed the fair use defense several times in the past decade, most recently in *Campbell v. Acuff-Rose Music, Inc.*, 114 S. Ct. 1164, 1177 (1994) (song parody was a fair use), which both sides argued extensively to both courts below. *See also Stewart v. Abend*, 495 U.S. 207 (1990) (motion picture adaptation was not a fair use of magazine story); *Harper & Row Publishers, Inc. v. Nation Enterprises*, 471 U.S. 539 (1985) (publishing substantial excerpts from President Ford's memoirs was not a fair use); *Sony Corp. v. Universal City Studios, Inc.*, 464 U.S. 417 (1984) (personal, non-commercial video recording of TV broadcasts – "time-shifting" – was a fair use). It is telling that Southeastern claims no conflict between these cases and the decisions below. Indeed, it cites *Campbell* only in passing[28] and does not cite *Stewart, Harper & Row,* or *Sony.* The reason is simple: *Campbell* and the other leading fair use cases establish that Southeastern's unauthorized commercial exploitation of Triad's service software is not a fair use.

Fair use is an affirmative defense to an infringement claim as to which the proponent bears the burden of proof. *Campbell*, 114 S. Ct. at 1177. The doctrine allows the limited copying of a work incidental to the creation of another, or to advance particular "public benefits," such as the development of art, science, or industry. *Id.* at 1169 (a fair use is one that "fulfill[s] copyright's very purpose, '[t]o promote the Progress of Science and useful Arts . . . ' "); *Rosemont Enterprises, Inc. v. Random House, Inc.*, 366 F. 2d 303, 307 (2d Cir. 1966), *cert. denied*, 385 U.S. 1009

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[28] Despite having argued *Campbell* vigorously throughout the district court proceedings and before the Ninth Circuit, Southeastern now says that citing *Campbell* is "frivolous." Pet. at 9 n.5. Other than pointing out that *Campbell* is about a song parody, however, Southeastern never says why. Southeastern understandably dislikes *Campbell*, because it involved limited copying in the course of creating a unique work not intended to replace the original, and thus makes Southeastern's wholesale, substitutive copying look particularly bad by contrast.

(1967); *Advanced Computer*, 845 F. Supp. at 365.[29] The defense is thus designed to prevent stifling " 'the very creativity . . . [the copyright] law is designed to foster.' " *Campbell*, 114 S. Ct. at 1170 (*quoting Stewart*, 495 U.S. at 236).[30]

Section 107 of the Copyright Act contains a non-exclusive list of four factors to be considered in determining whether a particular use is a fair use:

> (1) the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes;
>
> (2) the nature of the copyrighted work;
>
> (3) the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and
>
> (4) the effect of the use upon the potential market for or value of the copyrighted work.

17 U.S.C. § 107. Judge Smith found for Triad on all of these factors, as did the Court of Appeals. Pet. App. 15, 34-38. But under this Court's fair use decisions, there is a simpler, more direct answer to Southeastern's fair use claim.

This Court held in *Campbell* that an unauthorized copy which merely "serves as a market replacement for" a copyrighted work is not a fair use. *Campbell*, 114 S.Ct. at 1177; *see also id.* at 1181 (Kennedy, J., concurring) (what the copy "may not do is usurp demand by its substitutive effect"); *Harper & Row*, 471 U.S. at 550 ("the fair use doctrine has always precluded a use that 'supersede[s] the use of the original' ") (citation omitted). Therefore an unauthorized copy made by the copyright holder's competitor and offered as a direct economic substitute for the original work (or an authorized copy thereof) is not a fair use. *Id.; cf. Campbell*,

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[29] 17 U.S.C. § 107 lists as examples of fair uses copying in connection with "criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship, or research."

[30] Fair use has also excused some forms of personal copying, such as the "time-shifting" in *Sony*, 464 U.S. at 447-55.

114 S.Ct. at 1177-78 (a parody of a song and the original "serve different market functions"). Judge Smith followed this rule to a tee, holding there can be no fair use defense where "the infringing use usurps the market for the copyrighted work." ER86. So, pre-*Campbell*, did the court in *Advanced Computer*, 845 F. Supp at 366 (no fair use where copying of service software "clearly deprives [the copyright holder] of license fees"). No case is to the contrary. That is, no court has ever found a fair use where an entire copyrighted work was copied in a non-transformative way to commercially compete with the copyright holder. Yet that is what Southeastern does: It copies Triad's service software and uses it – without paying a cent for it or transforming it one iota – to compete directly with Triad. *See* Pet. App. 14 ("Southeastern invented nothing of its own").

Kodak had nothing to do with any of this. It is "another case that concerns the standard for summary judgment in an antitrust controversy." 504 U.S. at 454. No copyright issues were presented or discussed; hence, there is not a word in *Kodak* about fair use. It is obvious that there is not, and could not possibly be, a conflict between this case and *Kodak*.

Southeastern attempts to manufacture a conflict by juxtaposing a Ninth Circuit reference to Southeastern's "free riding" against this Court's rejection of a free-riding business justification defense in *Kodak*. There is no conflict because the Ninth Circuit was using the term in an entirely different context: Southeastern argued below that, as a matter of public policy, Triad should not be allowed to exploit its copyrights in any service-related market. Pet. App. 15. The Ninth Circuit disagreed, pointing out, first, that "Triad invented, developed, and marketed its software to enable its customers and its own technicians to service Triad computers," and second, that "Southeastern is getting a free ride when it uses that software to perform precisely the same service." *Id.* Both points are indisputably true, and lead to the court's conclusion: "Triad is entitled to licensing fees from Southeastern and other ISOs that make use of Triad's software in servicing Triad computers." *Id.*

In *Kodak*, on the other hand, the Court was addressing an antitrust issue. Defendant Eastman Kodak refused to sell replacement parts, over which it allegedly had a monopoly, to ISOs. It sought to justify its refusal on the ground that the ISOs would be free-riding on its investment in the equipment market even if they paid Kodak for the parts. The Court took this to mean that ISOs willing to make all necessary investments in the service market were being required to enter the equipment market too. The Court held that, as a defense to the ISOs' monopolization claim, "[t]his understanding of free-riding has no support in our case law." 504 U.S. at 485.

Southeastern inflates this limited ruling into a Supreme Court edict that ISOs "need not enter two markets in order to compete in one of them." Pet. at 19. But that is not what the Court held, nor is it what this case is about. All the Court held was that a potentially monopolistic refusal to deal could not be justified on the ground that ISOs should build copiers too. Paying license fees for using service tools or developing one's own is not entering an "equipment market," or any new market. Indeed, that was the Ninth Circuit's point: Southeastern is free-riding in the service market on Triad's investments *in the service market*, specifically Triad's investments in service software. There is, accordingly, no conflict between the treatment of free-riding in this case and *Kodak*.[31]

A petition for *certiorari* is not a proper vehicle for seeking legislative reform. That is really what Southeastern is asking: for the Court to use the legal doctrine of fair use as a means to establish, for unrelated, selfish reasons, an ISO

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[31] As noted earlier, this particular *Kodak* argument was not advanced by Southeastern below. On the other hand, Southeastern has previously claimed that dictum in a *Kodak* footnote, 504 U.S. 480 n.9, supports its fair use argument. It does not. Footnote 29 merely makes the unremarkable point that intellectual property rights can sometimes be abused, leading to antitrust liability. Some specific examples are then cited. This casual observation in a different context hardly means that copyright holders can't seek license fees from competitors. And the (affirmed) summary judgment for Triad on Southeastern's copyright misuse claim confirms there has been no abuse by Triad of its copyrights. Note 12, above.

exemption from the Copyright Act. The Court should not start down that dangerous path; it should instead deny the petition.

IV. EMBRACING SOUTHEASTERN'S ARGUMENTS WOULD SIGNIFICANTLY DISRUPT SOFTWARE INDUSTRY MARKETING PRACTICES.

A crucial reason to deny review is that, if the Court were to accept Southeastern's argument, its decision would have profound negative implications for the marketing of computer software in the United States. That is because, at bottom, Southeastern seeks to set aside two long-standing legal principles – that licensing a program is not the same as selling the program, and that electronic copies of a program are infringing copies – upon which there is widespread reliance. Judicially overhauling these rules in the manner Southeastern advocates would therefore have far-reaching effects.

Southeastern acknowledges that business software is almost universally licensed rather than sold outright. Pet. at 16. *See generally*, Practicing Law Institute, *Technology Licensing and Litigation* (1995); Raymond T. Nimmer, *The Law of Computer Technology: Rights, Licenses, Liabilities* (2d ed. 1992). There are many reasons for this practice, but one paramount reason is that copyright law does in fact make important distinctions between the rights of purchasers and licensees. For example, a "first sale" extinguishes the copyright holder's rights over a particular copy of a copyrighted work, whereas a license does not. 17 U.S.C. § 109(a). And, directly relevant to this case, Section 117 gives "the owner of a copy of a computer program," but not a licensee, the right to make certain types of copies that would otherwise infringe. Page 18, above. It should come as no surprise that software industry contracting practices have adapted to these copyright law principles. That is to be expected, not undercut.

Controlling "electronic copying" is also key to the integrity of the current software industry licensing structure. As explained earlier, it is in the nature of computer software that one who wishes to appropriate its economic value need not make permanent copies of the work. It is frequently sufficient

to take an existing copy resident on someone else's computer, use it for however long is required to suit the user's economic purpose, and then leave it behind. Over ten years ago, the courts cut off this method of depriving software copyright holders of their just reward. As a result, it is now clear that those who have not paid for their own rights to a copyrighted software program commit copyright infringement by using, and therefore copying, someone else's copy of it. If the Court now overturns all prior decisions and holds that electronic copying is not infringement, that would reopen the loophole and permit widespread appropriation of copyrighted works by unauthorized persons.

The Court should decline Southeastern's invitation to retrofit the software industry according to Southeastern's self-interested policy preferences. There is nothing novel or controversial about the decisions below. They apply settled law to a practice that clearly looks, smells and feels like blatant copyright infringement, and is recognized as such throughout the software industry.

CONCLUSION

For the reasons stated above, the petition for *certiorari* should be denied.

Dated: January 22, 1996

McCutchen, Doyle, Brown
& Enersen

Daniel M. Wall
Attorneys for Respondent
Triad Systems Corporation

COPY

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

APPELLATE JUDGES SNEED, CANBY, FERNANDEZ

JEFFREY LEDERMAN; MICHAEL J. MADISON; TRIAD SYSTEMS CORPORATION, a Delaware Corporation,	) Case Nos. 94-14818) and 95-15552) (C 92-1539 FMS)
Plaintiffs/Appellees,	) Friday, July 14, 1995
v.	) San Francisco,) California
SOUTHEASTERN EXPRESS COMPANY, a Georgia de facto partnership, dba SOUTHEASTERN BROKERAGE COMPANY and dba SOUTHEASTERN SYSTEMS; GEORGE BARNES, an individual; KEVIN CLARK, an individual; and GERRY WAMBOLT, an individual,	) Courtroom 3
Defendants.	
And Related Counterclaims.	

Appeal from the United States District Court for the Northern District of California before the Honorable Fern M. Smith

Appearances continued on next page.

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Proceedings recorded by audio cassette by the Ninth Circuit; transcript produced by transcription. Copy of cassette provided by the law firm McCutchen, Doyle, Brown & Enersen. Transcript produced by federally-approved transcription service.

[p. 3] Friday, July 14, 1995 9:00 o'clock a.m.

PROCEEDINGS

MS. LEHMAN: Good morning, Your Honors. I'm Mary Lehman of Gray, Cary, Ware and Freidenrich for appellant Jeffrey Lederman and Michael J. Madison.

I'd like to reserve to do about two minutes for a rebuttal of my ten minutes. Thank you.

This appeal presents a simple and single point of law. Under the applicable Rule 11, attorneys who did not sign the offending documents cannot be sanctioned as a matter of law. It is uncontested here that the old Rule 11, the Rule 11 that preceded the 1993 amendment, is applicable.

Under the old Rule 11 the signature was the essence. The signature's the same. That's clear from the statute. That's clear from caselaw. I'm quoting Pavelic, the purpose of that Rule 11 was to bring home to the individual signer the personal nondelegable responsibility of what he was doing.

THE COURT: How did the – the District Court said that the old rule applied.

MS. LEHMAN: That's correct, your Honor.

THE COURT: And that – I mean, what happened? Where – what was the District Court's theory for

upholding the two attorneys under the old version of the rule?

MS. LEHMAN: Well, we believe it was a mistake, quite simply. It was a mistake under – the interpretation of Rule 11 [p. 4] to the extent the Court thought it was sanctioning the attorneys under Rule 11 because as – as we all can acknowledge, Rule 11 at that time didn't allow sanctions for persons who did not sign the offending document.

But I think what the District Court thought, and this is reflected in the transcript during trial, is that under a particular case, the Mercury Service case, which is a District Court case, that the Court had to sanction the attorney.

But relying on that case was a mistake for a couple of reasons.

First of all, in Mercury Service the Court imposed sanctions on – albeit, facts similar to these – The Court imposed sanction under a Rule 11 jointly with inherent sanctions. So it's not clear that the attorneys were sanctioned for a declaration under Rule 11.

But secondly, and most importantly, Mercury Service was decided before the Pavelic and Le Flor decision from the Supreme Court which said that attorneys cannot be sanctioned clearly for a document they didn't sign.

And the mercury Service Court was very clear that it sanctioned the attorneys because their typewritten names were on the top of the pleading. So it was essentially a mistake by the District Court in relying on this case.

So there – I'm sorry. Is there a question, Your Honor?

[p. 5] The only –

THE COURT: So there's nothing to it in a real argument except they – they didn't sign it and they don't get sanctioned? That's it?

MS. LEHMAN: Right. And that's clearly – have to strictly interpret Rule 11 under the rules enabling that. And it's clear under the Supreme Court authority. I mean it's a pretty simple, straightforward issue.

THE COURT: Well, you don't have to beat us over the head.

MS. LEHMAN: Is that fair? No questions?

Okay. Thank you.

THE COURT: All right. Is the plan now to respond to the sanctions, –

MS. LEHMAN: I believe so.

THE COURT: – at this point, I hope, right, because I think we should keep it separate from the rest of it.

MR. CHRISTOPHER: Yes, Your Honor. May it please the Court, my name is Robert Christopher. I'm appearing on behalf of Southeastern, the appellee, on the sanctions appeal only. And we'll be using, unless the Court deems otherwise, only five minutes of the time, perhaps even less.

THE COURT: Well, you might not need it, but –

MR. CHRISTOPEHR: That I understand, Your Honor. And I'll be listening.

[p. 6] THE COURT: It seem – it seems to be open and shut. What can you really say?

MR. CHRISTOPHER: I'm sorry. I don't know what seem – it does seem to be very open and shut to us. We – we feel very strongly that, although we disagree with the District Court's judgment not to sanction Triad as the party who was responsible for the actual declaration, we have to concede that the District Court had discretion to award sanctions against these attorneys of five hundred dollars each. The –

THE COURT: Under – under –

MR. CHRISTOPHER: The –

THE COURT: – its general discretionary authority or what? I mean Rule 11 doesn't seem to work in the form in which it was applied, does it?

MR. CHRISTOPHER: Rule 11 does work, Your Honor. And as –

THE COURT: Okay. Tell me why.

MR. CHRISTOPHER: The – the basic argument that they made is that: Oh, we didn't sign the declaration so we can't be sanctioned. That seems to be the argument, isn't it, as I understand it.

THE COURT: That's the way I understand it.

MR. CHRISTOPHER: Okay. The Mercury Service case does cover this. In that case you had the declaration of a banking officer who lacked personal knowledge. That was the evidence or [p. 7] proof of the violation. While the attorneys who in that case had their

names on the motion, or I believe in that case signed the motion, that is what provided the signing element. And, indeed, that's what we have here.

It – it only takes a moment to look at who Judge Smith decided to sanction to – to fully comprehend that she sanctioned the people who signed the motion. Of course, she didn't sign the person – sanction the person who signed the declaration, because that was a different person.

THE COURT: So it's the motion, yes.

MR. CHRISTOPHER: It was the motion, Your Honor. And I think that's really quite clear from the record, because where else did she get the names, Lederman and Madison? Where else did we get the names Lederman and Madison?

When we initially filed the motion, we didn't know who had actually sat there for hours with Mr. Mullin (phonetic), the declarant, to do this. So we – we do agree with the appellants in one respect, though, –

THE COURT: So this is the general motion for summary judgment; is that –

MR. CHRISTOPHER: This was the motion for preliminary injunction –

THE COURT: For preliminary injunction.

MR. CHRISTOPHER: – first time around, Your Honor.

THE COURT: Yeah. Okay. And the only –

[p. 8] MR. CHRISTOPHER: We do –

THE COURT: How many affidavits were filed in support of that motion or depositions or whatever?

MR. CHRISTOPHER: There was one principal declaration of this business agent of Triad that was relied on forty-nine times in the – in their motion, and there were a couple of additional declarations on minor points.

I think at that point in time there was very little discovery in the nature of deposition testimony.

THE COURT: So –

MR. CHRISTOPHER: It was essentially the entire motion.

THE COURT: Okay. But the sanction is directed at the Mullin declaration; isn't that the object of it?

MR. CHRISTOPHER: Well, it was the Mullin declaration that offended, Your Honor. But the motion that relied on that, as pointed out in the Mercury Service case, was what offended.

THE COURT: The motion that relied on it was signed by the sanctioned attorneys?

MR. CHRISTOPHER: Yes, Your Honor. And that was the basis of the sanctions award and –

THE COURT: And that's – that's how –

MR. CHRISTOPHER: – Rule 11 in the Mercury Service case.

THE COURT: – Rule 11 gets into the picture.

MR. CHRISTOPHER: Yes, it is, Your Honor.

[p. 9] THE COURT: Where does the District Judge say that?

MR. CHRISTOPHER: The District Judge does not say that, Your Honor.

THE COURT: The District Judge –

MR. CHRISTOPHER: The District Judge –

THE COURT: – only talks about the declaration, correct?

MR. CHRISTOPHER: That's right, Your Honor.

THE COURT: Apparently the sanction – going to sanction because of the declaration. Yeah. Frankly, I think –

MR. CHRISTOPHER: Because of the attorneys –

THE COURT: – frankly, I think that the losses were caused because of responding – the sanction is for the cost of response to the declaration. And that's what I'm going to sanction for, correct?

MR. CHRISTOPHER: That's what the Court said, Your Honor.

But the – where the Court got the –

THE COURT: But you're saying that really she – she really thought she was sanctioning something else, right?

MR. CHRISTOPHER: She really was –

THE COURT: Is that your point?

MR. CHRISTOPHER: She was sanctioning the parties who she thought was most responsible. I think she was wrong in that sense.

[p. 10] THE COURT: Well, she was sanctioning the party she thought was most responsible for the declaration, correct?

MR. CHRISTOPHER: Yes.

THE COURT: Okay. But you're saying: But really she was sanctioning the lawyers for signing a motion that they shouldn't have signed, –

MR. CHRISTOPHER: That's the –

THE COURT: – correct?

MR. CHRISTOPHER: Yes.

THE COURT: But she just didn't say it, because Judge Smith doesn't know how to be precise about what she's doing. She doesn't say: I'm sanctioning these lawyers because they – the should have known the declaration was bad when they signed the motion. So I'm sanctioning you for signing that motion paper. She never says that or anything like that? Now, does she?

THE COURT: No.

MR. CHRISTOPHER: There are a lot of things she doesn't say in her order, –

THE COURT: Well, –

MR. CHRISTOPHER: – that are set forth in the arguments and are part of the record which supports the result.

THE COURT: Well, lots of things can support lots of things, but the point is when she came to do the sanctioning she's sanctioning the declaration, is she not?

MR. CHRISTOPHER: She was – your Honor, I can't –

[p. 11] THE COURT: She says she's sanctioning –

MR. CHRISTOPHER: – get inside Judge Smith's head. I really can't.

THE COURT: Well, no. None of us can. So all we can do is say: Well, since we don't – we never know what human beings' intent is, let us look what they did. And what she did was sanction the declaration, correct?

MR. CHRISTOPHER: She says she sanctioned – sanctioned the declaration, but she –

THE COURT: That's what she said.

MR. CHRISTOPHER: – but she sanctioned the two attorneys who were responsible for the motion and who had signed the motion on which the declaration – which relied on the declaration. And thus it seemed to me that she had the discretion to do that.

We do agree with appellants in one respect. The ruling below exercised poor judgment. This was a case that was analogous to but far more egregious than the Mercury Service case on which we relied.

It was a case in which the plaintiff's principal witness not only swore falsely that he had personal knowledge of numerous facts but, in fact, his personal knowledge contradicted those facts.

It is a case of bad conduct. It is a case in which the plaintiff predicted in the marketplace it would litigate our [p. 12] client to death. And then they threw this everything-but-the-kitchen-sink motion at us.

So the trial court's conclusion that former counsel was exclusively to blame and the consequent failure to sanction the real culprit, Triad, at all is un – incomprehensible to me. But was it an abuse of discretion to sanction the attorneys, Lederman and Madison, five hundred dollars each? I don't believe there's a chance of that. They got off easy.

Anyone who carefully examines this record, especially Mr. Mullin's declaration and later testimony, can see that. Anyone, of course not associated with Triad or its counsel, who to this day remain in complete and unrepentant denial about conduct which was quite offensive.

THE COURT: Well, that all may well be true, but as Judge Fernandez says, we're – we're stuck.

MR. CHRISTOPHER: Then, Your Honor, let me conclude this way.

We believe that this appeal is a legal shell game. They didn't make arguments below that they could have. They were involved; they claim they weren't.

THE COURT: Well, you know, –

MR. CHRISTOPHER: It's – We believe its frivolous.

THE COURT: Public, public fighting like this isn't going to get you anywhere.

MR. CHRISTOPHER: Then let me close with this, Your [p. 13] Honor.

In the alternative, if you find that there is merit to the appeal, we would ask that the Court remand it to the District Court with instructions to do it right this time, including recognizing the seriousness of the conduct involved.

And since the rule mandates some sanctions, I believe that means that Triad should incur significant sanctions.

Thank you.

THE COURT: Did you cross-appeal?

MR. CHRISTOPHER: We did not cross-appeal, Your Honor.

THE COURT: Okay. Thank you.

MS. LEHMAN: I'll just take a minute.

There's no basis –

THE COURT: Don't – don't push too hard.

MS. LEHMAN: – for –

THE COURT: I wouldn't take more.

MS. LEHMAN: Pardon me?

THE COURT: Don't push too hard.

MS. LEHMAN: Okay. There's no basis for the argument that it was in the discretion on – of the District Court to sanction the attorneys.

The only discretion is under inherent sanctions, and the Court specifically found there's no basis. And this didn't rise to the level of requiring inherent power of sanctions.

The signature-on-the-brief argument, that they were [p. 14] really sanctioned for the brief, is irrelevant. If you follow appellee's argument that the District Judge really sanctioned for the signatures on the brief it falls apart both logically and on the record below.

The first basic thing is that only Michael Madison signed the brief, so how can you sanction what was – if that was really – it doesn't make sense to say that was really the basis for the District Court to sanction the attorney.

Then even if you look to what were the typewritten names on the brief, there were four attorneys. So why would the District Court have sanctioned just two? It doesn't hold up.

It doesn't hold up on the record as well. The order says nothing about the brief. There was nothing sanctioned about the brief, per se.

The actual order says the attorneys were sanctioned for submitting, offering the declaration. But as we just discussed, under Rule 11, that's not sufficient and it – and it can't be, according to the Supreme Court.

THE COURT: That's okay.

MS. LEHMAN: Furthermore, in –

THE COURT: I've got the order right here.

MS. LEHMAN: And all –

THE COURT: Um-hum, all right.

MS. LEHMAN: And all the evidence shows that the attorneys spent numerous hours, over a six-week period of time, [p. 15] factually investigating the basis for the declaration.

Thank you, Your Honors.

THE COURT: Well, we'll then proceed to the remainder of the appeal.

MR. KATZ: May it please the Court, good morning, Your Honors, my name is Ronald Katz.

THE COURT: Mr. Katz.

MR. KATZ: And I'm appearing for the appellate, Southeastern.

With me, aside from Mr. Christopher, are Richard Jones and Janet Arnold Hart.

THE COURT: Mr. Katz, you've been on this case quite a long time, haven't you?

MR. KATZ: I've been on the case quite a long time?

THE COURT: Yes.

MR. KATZ: It seems like forever, Your Honor.

THE COURT: It seemed to me when I was looking through it, your name is everywhere.

MR. KATZ: Last year I had the occasion to write a review of a book about the first fifty years of this

Honorable Court, called *Rugged Justice,* by David Frederick.

And I was struck by the uniquely important issues faced within our Circuit. And I think that when the second fifty years, the history of the second fifty years is written, one of those uniquely important subjects that our Circuit addresses is [p. 16] high technology.

And I believe that when that history is written, the landmark case will be Sega versus Accolade. And I believe that that case disposes of this matter in the narrow – narrowest, clearest and most important way.

The most important thing about Sega is that it looks at a new technology, software, and laws that were created before that and it recognizes, most importantly, that software is functional. I refer you to page 1524 of Sega, which reads as follows:

To the extent that there are many possible ways of accomplishing a given task or fulfilling a particular market demand, the programmer's choice of program structure and design may be highly creative and idiosyncratic. However, computer programs are, in essence, utilitarian articles, articles that accomplish tasks.

And again on page 1525 it talks about the essentially utilitarian nature of computer programs. We have to start from that.

Now if we look at the way –

THE COURT: Now I suppose maybe the key in that case could have been that the small number of bits that had to be reproduced there were the only way to get into the thing; is that –

MR. KATZ: Well, that was not the deciding factor in [p. 17] the case, Your Honor. The deciding – I mean I – I hesitate to tell Your Honor what the –

THÉ COURT: No. Well, I –

MR. KATZ: – deciding factor was because I know Your Honor was on the panel, but –

THE COURT: There may have been a lot of deciding factors in that case.

MR. KATZ: The – I'm going to get to what I think was the deciding factor in a moment, and more important, the philosophy behind that, the round pegs and square holes, if I may.

THE COURT: Okay.

MR. KATZ: Triad does not accept this. If we look at their brief and how they characterize the language that I just read, they give one sentence but not the other.

Page 25 of their brief. They give the sentence that to the extent that there are many possible ways of accomplishing a given task, the programmer's choice of program structure and design may be highly creative and idiosyncratic. And they even say: Okay, that shows it's – it's creative.

And then they don't cite the second sentence, which says that basically, inspite [sic] of that, this is still utilitarian.

I believe that that conduct is sanctionable, citing that language in such a misleading manner.

And then they go on to say in their footnote of that [p. 18] page: Well, – and refer to a question I asked some programmers there: Well, if you had been given the assignment to write this program, you'd come up with *Hamlet*, that you wouldn't have fulfilled your assignment.

And they said: Oh, that's a silly way of doing it. And – and creativity really doesn't come into it that way.

But then again if we look at Sega, Sega says there's a big difference between functional works, factual works and creative works, and says that the pre- – the protection for functional elements is very – and this is, again, on page 1524, citing Baker v. Seldon (phonetic), which is an old Supreme Court case on this matter.

The Sega ca- – case goes on to hold that even literal copying is okay in some cases. And, again, on page 1524 it says:

In some circumstances even the exact set of commands used by the programmer is deemed functional rather than creative for purposes of copyright.

When specific instructions, even though previously copyrighted, are the only and essential means of accomplishing a given task, their later use by another will not amount to infringement, because that was really the heart of the Sega case. They said we have to look at how object code is done.

And object code is such that it protects many different things. It not only protects what should be protected, which is the expression, but it also protects functional things and it [p. 19] also protects things that should not be protected.

And that's why we have to look through that and we have to come a conclusion which says that those things are simply not protected. And that's what happened in this case.

THE COURT: How do you deal with the MAI?

MR. KATZ: Well, MAI – we can live with MAI. MAI is an incomplete case because it does not do the fair-use analysis.

I have – when I was in law school my constitutional law professor Paul Froen (phonetic) said that the final courtroom review is the *Law Reviews*, and that there's a certain amount of truth to that.

I have tried to locate all the *Law Review* articles on the MAI article – on the MAI case. And they are unli- – uniformly critical. There is not a single one that supports that case. And I think it's unfairly critical, unfairly critical because the fair use issue was not before the court, and therefore the court was obligated not to decide that issue. So MAI, when that history of the next fifty years of the Circuit is written, will be a footnote because it simply was an incomplete matter.

If I may give Your Honor some cites, 44 *Duke Law Journal* 327, here's what that says about the MAI case, and I think it's typical:

The MAI System case demonstrates how a series of legal determinations, each somewhat defensible as a mechanical [p. 20] application of statutory language and caselaw precedent, can yield a result that is plainly at odds with the policies behind the statutes it seeks to apply.

The MAI Systems court erred both in holding that loading program on to RAM constitutes a copy and excluding Peak (phonetic) Computers customers from the scope of 17 USC Section 117 which stipulates that certain uses of copyrighted computer programs by the owners of copies of those programs or those authorized by such owners are deemed not to be copyright infringements.

It is the combination of these two determinations, however, that so distorts the vision not only of the Computer Software Act of 1980 but of the Copyright Act as a whole.

And then there are other citations all along the same lines –

THE COURT: Have your opponents gone as far as you are urging by saying it's okay to turn it on?

MR. KATZ: That is a sham issue, Your Honor. You – when you turn on a computer, you have to be able to run the computer. You have to be able to operate in order –

THE COURT: Well, when you turn it on some things happen that might otherwise be considered a violation of the Copyright Act if it's not turned on by a licensee, isn't it?

MR. KATZ: Well, I don't believe so. I believe that it's a fair use. I believe if we follow – the –

[p. 21] THE COURT: If – aside from fair use –

MR. KATZ: – rule of Sega is that if you're – doing intermediate copying –

THE COURT: Aside from fair – aside from a defense of fair use.

MR. KATZ: Well, right. That's what's the –

THE COURT: I mean, in other words, you –

MR. KATZ: I think actually –

(Simultaneous talking.)

MR. KATZ: – under 117 Sega helps us, too.

I think that – here's what Sega does on 117: What it does, first of all, is to set out that the CONTU (phonetic) Report is authoritative for Courts.

And then it goes on to cite the language from the CONTU Report that says that a lawfully possessor may make or authorize a copy in the use of the computer.

So I believe that that was decisive on that issue. I have to admit that MAI disagrees with that. So because MAI disagrees with that, either the Court will have to deal with MAI in some way, or just say: MAI was incomplete because it doesn't go to the fair use analysis. So I think we should win on 117, but we certainly win on 107.

THE COURT: Well, Judge Smith –

MR. KATZ: There's nothing to be ashamed of –

THE COURT: – did not – did say that she was going on [p. 22] "turning on the computer" principle.

MR. KATZ: Well, this is a way in which –

THE COURT: I mean, otherwise, she – she –

MR. KATZ: This is a way in which MAI helps us, okay.

THE COURT: Yeah.

MR. KATZ: Okay. Because you have something in the computer which is necessary to make the computer run, and that's called different things. It can be operating system. You know, it can be called operating software.

I have a blow-up here of an important exhibit, which Your Honors have, it's the other side of this so I can display.

Exhibit 380A – I'm sorry if it's too small for you to see. It's in the Excerpts of Record, Volume II, page 459.

And basically what is put in the computer, what is sold at the time that the computer is sold is what Triad itself calls operating software. And that includes the operating system and utility software associated with such hardware and provided to the customer under this agreement. That's what it takes to make the computer run.

THE COURT: Well, does that include –

MR. KATZ: And another –

THE COURT: – would that include the utility software you just referred to here?

MR. KATZ: Yes, it does. Yes, it does.

And if we look at the MAI case, –

[p. 23] THE COURT: Does the utility software do more than that?

MR. KATZ: Pardon?

THE COURT: Does the utility software do more than that?

MR. KATZ: Utility software does a variety of things, but you can't separate it out. It's like saying you can – you can drive the car, you can turn on the ignition, but you can't use the fan belt or you can't use the gas.

You have to use it all or nothing. You have to use the –

THE COURT: The reason I ask, of course, is that as the – as the issue seems to be framed in the briefs, the argument is: Well, the utility software does a lot of diagnostic things that corrects glitches and things like that are not part of the really basic operating system, and that maybe you should design your own utility system if you want to service these computers.

MR. KATZ: Well, I mean –

THE COURT: I think that's their argument.

MR. KATZ: Right. And I think that's wrong on two counts.

First of all, the rule of Sega is that if you put some things that are protectable with things that are unprotectable and then you've got this object code system and you have to print everything in order to – to do an intermediate copying, to do [p. 24] something legitimate, which is to service the computer which is certainly legitimate, then the fact that the other stuff is copied is a fair use. Okay. That's number one.

Number two, –

THE COURT: You couldn't copy – you couldn't then – you can't trigger the operating system without result – regarding utilities.

MR. KATZ: It's all – it's all together.

Number two, –

THE COURT: All right.

MR. KATZ: – this is a – an incorrect argument that they brought up at trial, and actually MAI helps us in this regard. The – if you look at – let's see if I have a copy of MAI here, . . .

If you look at MAI at footnote 3, it distinguishes between the software license and the diagnostic license. Normally diagnostics is something that's entirely separate from the operating system. But I don't think that this should be decided on a word.

And then if you look at footnote 4 of the MAI case, it talks about operating software, the same thing that it talks about here. It says: MAI also alleges that Peak runs its diagnostic software in servicing MAI computers. Since Peak's running of the operating software constitutes copyright violation, it is not necessary for us to directly reach the [p. 25] issue.

But the point is that there is a bright line here. The bright line is what does it take to run the computer. And if you copy something that's protected on there, given the nature of software as the Sega case says, that is a – and you do it for a legitimate purpose, it's just intermediate copying, there's no proliferation, there's no usurpation of market, and here there is no usurpation of market, there's no – nothing to sell, the copy disappears, then that is a fair use. Sega controls this. MAI is incomplete.

THE COURT: So if I understood what you're saying, you're saying that the operating software, the

application soft- – software, the utilities – diagnostic and the utility software, all of those are fair and they can be used by servicers without violating –

MR. KATZ: No, Your Honor. The – no, no. The – the applications are separate.

You have, on the operating software, you have the utilities and you have the operating system. Applications are something separate. You don't have to run –

THE COURT: Well, they're separate because they do the thing for which the software is designed.

MR. KATZ: Well, applications –

THE COURT: They do the – they do the accounting.

MR. KATZ: Application software are not at isn't in [p. 26] this case, Your Honor.

THE COURT: No. But it's part – it's part of the package.

MR. KATZ: No, it isn't. No, it isn't. It's not what you load into the computer to make it run. It's something separate.

Like, if you want to buy an applications program for Microsoft, for example, you want to go buy a word processing –

THE COURT: Well, in the same way it is separate just in the same way, it seems to me, utilities, diagnostic, et cetera are separate.

MR. KATZ: No. You have the operating – if we just look at this document which is a Triad document. You start out, you have the operating software.

THE COURT: Okay.

MR. KATZ: Then you have something separate called the applications software, –

THE COURT: Right.

MR. KATZ: – which they can control. They don't have to necessarily put that on. It is separate. And then you have support services.

So what we're concerned about is simply what you need to make the computer run, because it stands to reason: You cannot maintain something if – you can't take your car in to your mechanic and say: I want you to fix it, but don't turn it [p. 27] on to see if it's running.

And, indeed, this will become relevant to car, –

THE COURT: But you – you –

MR. KATZ: – sir.

THE COURT: Your people turn on the computer and you utilize the service software.

MR. KATZ: It is not service software, Your Honor. It is a utility.

THE COURT: Well, whatever word you want to – I'm – I –

MR. KATZ: Well, I'm using their words, Your Honor. We are –

THE COURT: Utility, diagnostic, utility software; is that the way you want to put it?

MR. KATZ: We are turn –

THE COURT: Utility software, you use it, right?

MR. KATZ: We use what's called the operating software, which is absolutely essential to make the computer run. You cannot make the computer run without it.

THE COURT: Well, do you – are you telling me that all you do is turn it on?

MR. KATZ: We turn it on and we operate it in order to see –

THE COURT: And what software do you use in operating it to perform your –

[p. 28] MR. KATZ: There's only one software you can use. You can only use the operating software. You'd have no choice. That's why Sega applies here. There is no choice whatsoever.

THE COURT: Well, there you – that's not the way I understand the facts, but that's the way you tell me, and I'm no computer expert.

MR. KATZ: Well, that is my understanding, anyway. Obviously your understanding of it is much more important than mine.

But that is the way – you can only –

THE COURT: Not necessarily.

MR. KATZ: – use the operating system. That is the problem with this case, because we are having a

situation – they – they put the case of we're a tax protestor.

But the fact is that no one, before MAI was decided, no one in the world, not even Triad, thought that it would be a – an infringement to turn on the machine for the purpose of maintaining it.

If you visited a colleague on the Eighth Circuit and he wanted to show you something on his computer, and you did a few keystrokes on it, you wouldn't say: Well, do I have a license to do this? You would just assume that you could do this. And that's why there has been such vilification of the MAI case. And I say unfairly because that issue was not reached.

But now the combination of these two things would be [p. 29] devastating. You would literally change the computer industry as we know it.

The – Sega goes on to analyze how the nature of software leads to a de facto monopoly over functional concepts, which defeats the purpose of the Copyright Act. And that's on page 1527 of the Sega case. And that I think – I would say that this is the deciderada (phonetic) here. That is what is the landmark aspect of this.

And it says: –

THE COURT: Let me see if I really understand your argument. Your argument is basically Sega recognizes fair use. Turning on this computer and using it for the purpose of what Southeastern wants to do, is fair use, –

MR. KATZ: Yes.

THE COURT: – period.

MR. KATZ: Period. That's right.

Just like you can go to your auto mechanic and he can turn on your car to see if it's working. This actually will become an issue with cars soon, because there's something called onboard diagnostics where you will have your car reprogrammed rather than repaired.

And you cannot – if you are a vendor, if you are a manufacturer, you cannot put a whole lot of functional stuff and unprotected stuff in with the protected stuff and say: Aha, you can't use it, if that's the only way to do what you have to do [p. 30] and it's a legitimate thing.

And I – I submit to you that if you take the Sega case, on page 1526, that was about disassembly of object code. I'm going to read you some language there. But instead of saying "disassembly of object code," I'm just going to say "loading of software into a computer," because that's what this case is about. And you'll see how that case is on all fours with this one. Okay?

Look at – this is page 1526: Loading of software into a computer necessarily entails copying. These facts dictate our analysis of the second statutory fair-use factor. If loading of software into a computer is, per se, an unfair use, the owner of the copyright gains a de facto monopoly over the functional aspects of his work, aspects that were expressly denied copyright protection by Congress.

And that's precisely what's happening in this case.

THE COURT: Well, that – that is really is a head-on argument, I admit.

MR. KATZ: The – that – the MAI case is actually helpful to us on a couple of points here. The most

important one, of course, is burden of proof: That you have to show copying beyond the scope of a license, which was never done in this case.

There has never – there has never been any proof that we did any copying. All they said was: We didn't check because [p. 31] nobody ever checked this. And if you read these *Law Review* articles, you'll see why nobody ever checked them.

In fact, let me finish giving you the cites of those law review articles, because I think that they are –

THE COURT: If these aren't cited in the briefs you should leave them with the Clerk after the argument, to cite –

THE KATZ: All right. Fine.

THE COURT: – the actual citations with copies to opposing counsel.

THE KATZ: All right. Fine. I will do that.

The –

THE COURT: We used to have a quaint custom called gum sheets.

THE KATZ: Pardon me? I'm sorry. I didn't hear you.

THE COURT: I'm saying if you're interested in history, we used to have a quaint system called gum sheets.

THE KATZ: Gum sheets. No, that's –

THE COURT: And when you added to the citations, you were supposed to stick them on a gum sheet and hand them to us.

THE KATZ: That wasn't in Mr. Frederick's book. I didn't pick that –

THE COURT: No, probably not.

THE KATZ: I didn't pick that up.

There are a couple of other – I mean very important grounds that you can reverse this. One is the nature of the [p. 32] injunction itself, which is far too broad. It is mandatory. It – it stops legal activity as well as illegal activity.

And perhaps the most important procedural ground is that the case was bifurcated over our objection, and bifurcated away our defense, copyright misuse; and our antitrust claims, which would also provide a defense to the injunction.

So the Judge said she would not enter judgment, but then she did end up entering a preliminary injunction. And I don't know how you can find a probability of success when the – when the defenses are bifurcated away.

Exacerbating that was the unprecedented notion of giving us the burden of proof. There's a little confusion on that. I think the burden of proof – there is something – there are – there are two sides to this case.

One is the distribution side of the case and one is this MAI copying side of the case.

On the distribution side of the case there is an affirmative defense called the first-sale doctrine. And the defendant does have the burden of proof on that.

But on the copying side of the case, the MAI copying side of the case, there is no such affirmative defense. And the burden is, as stated in MAI, you have to show beyond the scope of a license. It is important to say – all they said was: If you have a lot of contracts out there – which we didn't get, we asked for under Rule 1006 – and the likelihood is that they did [p. 33] this sometimes but didn't check, but they never showed a single instance of copying.

And, indeed, because we tend to deal with older machines, that we may not have infringed. But there has never been a showing that we infringed. This was strictly a statistical case of we were not given, under Rule 1006, which is mandatory, we were not given the underlying contracts so that we could evaluate that.

THE COURT: Well, let me ask you about those contracts. I understand the Regimes and that sort of thing, and –

THE KATZ: Well, you're ahead of most of the world then, Your Honor.

THE COURT: Well, I understand it in a kind of superficial way. Let's put it that way.

But under Regime I, no one has ever contested your right to use them and to –

THE KATZ: Well, I would say the injunction contests it, because the injunction would give us pause before doing anything.

THE COURT: Well, I'm going to get to this now.

You don't know what machines are covered by Regime I, I take it.

THE KATZ: We don't have a clue, Your Honor. This is the most messed-up system –

THE COURT: Does Triad know?

[p. 34] MR. KATZ: I don't know if they know or not. They say they've destroyed most of the documents.

THE COURT: They should know.

THE KATZ: There's serial numbers. They sold the machines. But they claim that they don't know and they claim –

THE COURT: Well, we'll ask them when they come. But it seems to me this would give you some slight encouragement, that –

THE KATZ: Well, the – the burden should be on us, correct.

THE COURT: They have a – they have a problem there.

THE KATZ: I think they have a major problem. It's been the problem of this whole thing.

THE COURT: It seems to me that they should demonstrate that they cannot know the machines and the reasons therefor.

THE KATZ: Well, it gets worse in the used market.

THE COURT: I don't know how you would ever find out.

THE KATZ: It gets worse in the used market. But there are serial numbers on each machine. They obviously should have the original documentation.

I probably represent more independent service organizations than anyone in the world, and no one keeps records of what's the Regime – none of the service organizations keep records of was it Regime I or Regime II or Regime III, just like your automobile mechanic doesn't keep records of what the nature [p. 35] of your contract was with General Motors.

I mean that is an absurding. Somehow that became an issue in the case, unfairly I think, and may have had on influence on – on Judge Smith, because she did some things that were highly unusual, including making a joke, the like of which I have never heard in a courtroom.

She had an expert witness up there and – who was an expert. And I was trying to show that his word wasn't the last word on things, and that the judiciary had agreed – disagreed with him on certain cases. He acknowledged that.

And she said she apologized to him on behalf of the entire judiciary, which – it's unprecedented. You've had more experience than I have, it really is unprecedented in my experience that such a remark would be made. And I – I don't think that it can help but have an effect on the jury.

So there were a number of very procedurally irregular things. I – the other side is fond of saying: Well, it

doesn't what matter what the jury did, this all comes from Judge Smith. But Judge Smith acted because of what the jury did.

And she did not have the grounds – and she – first of all, she took fair use away from the jury, again, citing Sega: Fair use is a mixed question of law and fact. She decided everything.

She just – and she made some things that are mistakes as a matter of law. She decided that it was a creative work, not [p. 36] a utilitarian work. And she cannot decide that as a matter of law in the face of Sega. She simply cannot do it.

If I may, unless there's further questions, I'd like to reserve the remaining two minutes of my time.

THE COURT: Certainly.

THE KATZ: Thank you.

THE COURT: So we'll hear from Triad.

MR. WALL: May it please the Court, my name is Daniel Wall, and I represent Triad Systems Corporation.

THE COURT: Mr. Wall.

MR. WALL: Regrettably I must begin my argument, as I tend to begin my arguments in this case, by correcting a number of very serious misstatements about the record, because it obviously matters a great deal to what you – how you evaluate this case, what you think it's about.

This is an appeal from an injunction. And because of that, the injunction defines what this case is about. It is *about no more and it is about no less* than what the injunction prohibits.

And this injunction, on its face, which of course you have, relates this case to a suite of specially-developed software tools that are used by the service technicians to maintain Triad Computer Systems.

The software is listed. If you'll on page 4 of the preliminary injunction, which is at page 474 of the record, you [p. 37] will see this page with all of these three-letter acronyms, and some others that are described with words. That is the software that is at issue in this case. It is no more and it is no less.

And it is the nature of this software that it was developed by Triad's software engineers to be service tools for the repair and maintenance of Triad computers. It was developed for Triad's own inhouse service force.

Now what has happened in this case is that Southeastern, a competitor, has chosen to use this software without limitation for its intended purposes and for the value inherent in it and for its commercial gain, so that it can gauge – engage in commercial competition with Triad.

In other words, what we are talking –

THE COURT: No. That's not a quite accurate characterization. They're not making and manufacturing computers that are competing –

MR. WALL: Competing for service.

THE COURT: – competing. The competition is, as you've just said, limited to service.

MR. WALL: Absolutely – well, actually it's not true. They – they actually make their own separate computer products. They – they have actually put software development –

THE COURT: As far as this case is concerned –

MR. WALL: Yes. This case –

THE COURT: – they're not copying your – your [p. 38] machine.

MR. WALL: They – they sell used machines, and there's some aspects of that. They also make their own software programs. Their own software programs have nothing whatsoever –

THE COURT: Well, that – that sort of identified as a used car salesman for several years –

MR WALL: It would, I think, be somewhat demeaning of them to call them a used car salesman, frankly. They – they're a company – developed add-on products. They developed their own peripherals. They developed their own software. But this case is about the use of the Triad service software.

THE COURT: Well, I understand that.

MR WALL: And that's all that we're talking about here.

But what it really is is you have two service companies, one of which has invested in the development of special software tools. The other which wants to use

those tools, could get a license for it, but won't pay for it. And they – they've decided to simply use them. And they claim that it's a fair use.

THE COURT: Would you sell them a license?

MR WALL: The testimony is clear that we would sell them a license. We – you know, I think of the – of the line from *My Fair Lady* of – of I'm waiting to sell them a license. I'm wanting to sell them the license. I'm hoping to sell them [p. 39] the license.

What they have testified is that it is against their philosophical principles to pay a competitor anything for the use of software which they say they only use to help a customer service their computer.

Of course, what they – what they use it for is to sell these insurance contracts, these service agreements, for which people pay two hundred and fifty, three hundred and fifty, four hundred and fifty dollars a month to get a suite of services. So that's what the case is about.

Now I think it is a good idea to start the analysis of this case with MAI, because that's also what MAI was about. MAI was essentially on all fours with this case, except that it goes a little bit farther than this one.

And that's been a lot of discussion in this case about MAI going all the way to the point of turning on the computer. Now, you know, if Mr. Katz, I don't understand his argument. Is it a sham, as he says, this issue of turning on the computer, or is that the essence of the case? He seems to go both ways during his argument.

We sought an injunction that expressly allowed them to turn on the computer for the very specific reason that

we did not want to continuously hear this notion about the mechanic who can't turn over the – the engine to see whether it works or not.

They can provide hardware service and they can turn on [p. 40] the computer for that –

THE COURT: That's like giving a starving man a brick, isn't it?

MR WALL: It's like giving – it's like giving a person who has three lines of business an unfettered right to two of those lines of business, even though under a decision of this Court we could have precluded them from the whole thing. I mean that's – that's a big difference here.

They, you know, they say that the restrictions are the issue. The restrictions are the things. You know, we think that what this case has to be understood as is a situation where they need something that we have and that is copyrighted.

In that world, in the situation, and in this – in this country, in the copyright system, that puts us at a very important advantageous relationship over them.

And there have been cases, the First Circuit decision in the Grumann versus Data General case and the Fourth Circuit decision in the Service and Training versus Data General case, where the courts have held that it is the lawful exercise of the copyright monopoly to deny this software completely on any terms and any conditions to the independent service organization, that that is neither copyright misuse, nor is it a violation of the antitrust laws.

We could have gone that far. We chose not to. We chose –

[p. 41] THE COURT: By that you mean you could have – you're still saying that you could have told them they can't turn it on, but that's not what you did.

MR WALL: We could have told them they couldn't turn it on and we could have told them to forget ever seeing a license from us.

THE COURT: That's hardly – to me that's just an irrelevant concession. I know where you're – where you're coming from, but it doesn't make – it doesn't get at the case.

MR WALL: Where I'm coming from, your Honor, is I think one of the great misperceptions about this case that has been – and it's been said over and over and over again – is that this is a case about a copyright holder that is trying to suppress competition. That is false. That is false.

This is about a copyright holder who wants to be paid for special service software that it developed. And, you know, this case –

THE COURT: Well, then – then I guess I don't understand about the turning on, because turning – does turning it on activate the special service software?

MR. WALL: No. And that's – that's a very important point that I think needs to be corrected, because it is, again, a complete distortion of the record.

When a Triad customer is delivered a software tape, he is given a set of tapes that have literally every software [p. 42] program that Triad makes for that computer. It has the – the operating system in what I sometimes call a sort of life support sense, the – that allows you to so-called turn on the computer.

It's got the rest of the operating system, which has some very basic sort of rudimentary diagnostics.

It has these special service utilities and that it – it has literally every applications program that Triad makes.

Now the – the logic of Mr. Katz' argument is that we could not deny people the use of any less than the whole of that because they are packaged together. But the way software licensing works in the real world and the way it works in the Triad world is that a person licenses the parts of those programs that they are – that they want that – and that they're willing to purchase.

For example, while we may have fifteen or twenty applications programs on those tapes, people tend to buy four or five, six, or license four or five, six, whatever they need.

The service software, which is – which has to be separately activated – it is utterly false for Mr. Katz to tell you that this is just something – this is like the fan belt on the car. That when you – when you turn on the computer, the fan belt must – must, of course, function. That's utterly false.

What one has to do in this – in this situation is to call up those programs through a series of routines which are essentially the work of the service technician. You see –

for [p. 43] example, one of the – the most frequently used programs is something called List Illegal Records. And it is a way of finding flaws in the record structure of the hard disk.

You have to call up the program, LIR, and then you have to perform a series of – of steps, which computer technicians are trained to perform. You have to interpret the screens that – that are brought up by that program.

And then, in a typical situation, you would activate another set of programs, which – which are more in the nature of utilities rather than diagnostics, to correct the problem, to purge the illegal record, to reset what's called the flag on it. It's a – it's a highly technical sort of work.

There is – the – the user of the computer who turns it on every day does not do these things. That's what they contract with service companies to do. That in the business of the service company, is to provide them the expert use of these particular programs.

So this is not a situation like Sega, where there was this sort of trap in the system that you – you had to – the trap in Sega, you may recall, there were a couple of them. There was the – the trademark screen that – that you could not avoid bringing up, so that the Sega trademark was – was brought up automatically, even when Accolade developed its independent game.

And there were a few lines of code, which this Court held, were – were the unprotected functional elements of that [p. 44] particular program, among many protected elements, that – that try as it might, Accolade could not

engineer around. And so it copied an infinitesimal small part of the program.

This has nothing to do with that. This is a case where they have – where we have developed these service tools, and they use them whenever they want. That's what this case is about: They use them whenever the want.

And the fundamental disagreement between the parties is that we think they should have to pay for that right and they think that it is a fair use.

Now going back to MAI. MAI enjoined this very thing. This is what a – MAI enjoined. It was a case, a – a computer manufacturer and an independent service company. The independent service company was copying – copying the operating system software and it was copying the diagnostic and utility software. And this Court enjoined that.

Now Mr. Katz says that the Court didn't consider fair use. I doubt the Court thought that the very thing which the copyright law prohibits could be a fair use.

There's a lot of ways that one can – can approach this fair use argument. You can do it like Judge Smith did it and the way that courts tend to do it, which is to march down the four statutory factors.

She did that. She found that the – that to directed verdict standards that every fact favored Triad. Every single [p. 45] fact favored Triad, which is to say that the use was purely commercial and not the least bit transformative, which is to say that the work was a creative work.

Now he says she cannot find that. That's false. This Court has recognized many times that software can have a creative expression.

Judge Canby, you so held in the Johnson Controls –

THE COURT: Um-hum.

MR WALL: – versus Phoenix Control Systems.

And his argument would suggest that software is not copyrightable because it's just functional. It just performs a function.

I'm sure that would come as a surprise to the people in Microsoft and the people at Apple and the people at software companies around the – the world who count on the copyrightability of software, that because their – their software has a use it is not copyrightable. And that's just not the law.

She also found that the – what they copied was the heart of the service programs. And she also found that it was a situation where it did usurp demand.

It was not a situation like in – in Sega where all Accolade wanted to do was develop its own creative game with – and all it wanted to do, all it had to do that caused it to decompile the code and therefore copy it, was to try to [p. 46] understand how to make it compatible. That's – that's a hundred miles away from this case.

That was a growth of creative expression. That was a better world because Accolade was able to make new, creative and independently copyrightable games by copying a fraction, a tiny, tiny fraction of the – of the – of

the code from the Sega system for the limited purpose of making the game compatible.

To equate that with a situation where you simply take the programs wholesale, use them whenever you want, is – is not tenable. That – one has nothing to do with another.

Now there is, I think, a much simpler way to deal with the fair-use issue. And that is by remembering what it is an exception to. And it is an exception to a rule of copyright infringement, the very essence of which is that you cannot take somebody's copyrighted work and commercially exploit it. And that's what this Court enjoined in MAI.

And, you know, there's an irony to this argument, because a year ago we had filed our second preliminary injunction motion. And at that time we argued very strongly to Judge Smith that it was improper for her even to consider overruling MAI by finding that the conduct which was enjoined was a fair use.

Now we lost that argument. We almost appealed from it. We – we decided to go to trial instead. But now to hear him say that – that your work on the MAI case can simply be sort of brushed aside because the very conduct is fair, it is not a fair [p. 47] use. It is not fair either in the simple, equitable sense that to the – sort of – the sense that – that when I tell my kids they have to do their homework, they say that's not fair. Nor is it fair in the – in the technical sense of the fair-use doctrine.

Now there are a couple of these other issues that – that I do want to cover because, again, I think they relate –

THE COURT: While you're on fair use, –

MR. WALL: Um-hum.

THE COURT: – would you tell me whether you can identify the contracts under the different Regimes?

MR. WALL: Yes. And let me – and let me do that in two stages. That's actually the issue I was about – about to address now.

THE COURT: Well, kind of a yes and no is – is a pretty good answer.

MR. WALL: Well, yes is the answer.

THE COURT: Okay.

MR. WALL: Well, let me make it – the answer was yes, –

THE COURT: Okay.

MR. WALL: – and let me explain why it is. It is yes. There's two reasons why it's yes.

First of all, this Regime issue is the – is, in fact, the great red herring of this case. Triad is undoubtedly [p. 48] laboring under a burden that for the first year and a half of the introduction of the Series 12 computer system, which is the only computer system that's at issue in this case, it was still following what is now an ancient and archaic industry practice of –

THE COURT: I understand that.

MR. WALL: – selling the software.

THE COURT: I understand that.

MR. WALL: Okay.

THE COURT: And I don't need it, because I've read it.

MR. WALL: But what I'm getting at is that there – there are approximately, at most, eleven percent of the Series 12 computer systems that were delivered in the period of time when Triad was selling the software.

THE COURT: That's eleven percent of the total systems out there?

MR. WALL: Eleven percent of the total number of systems that were ever delivered.

THE COURT: Yes.

MR. WALL: Now we're ten years later. Some of those systems are undoubtedly no longer in – in use. But eighty –

THE COURT: Can – can you identify what that eleven percent consists of?

MR. WALL: What we can identify – yes. Yes, we can.

First of all, we can do it in a number of ways. [p. 49] There's a whole bunch of models that one simply excludes because those models were – were introduced after the –

THE COURT: You can identify?

MR. WALL: Absolutely. And that is – I'm telling you that is one of the great red herring of this case.

THE COURT: Have – have you ever identified them in this proceeding?

MR. WALL: Absolutely. What we did is we put on a damage study. The essence of the damage study was – was the damages from – I believe there's a hundred and eleven specific systems that they were servicing.

For every single one of those systems we had our – our expert look at the documents which they had. It is another false statement that they didn't have the document –

THE COURT: Well, wait a minute. Wait a minute. You can identify them. And if the – if Southeastern came to you and said: Is the system I'm working on now a Regime I system or not, you could answer it?

MR. WALL: And, indeed, we have to, under the injunction. This is – this is a critical point about this –

THE COURT: Well, there seemed to be some dispute in the –

MR. WALL: There's no dispute –

THE COURT: – note and so on.

MR. WALL: – about what the order says. It's sort of [p. 50] like your comment earlier when you – when you –

THE COURT: Yeah.

MR. WALL: – held out the order under Rule 11. That's the great thing about writing these down, –

THE COURT: Yeah.

MR. WALL: – is that we can look at them and don't have to read minds.

The order provides that if there is any uncertainty about the – the status of one of these systems, that the customer can ask Triad to prove, essentially, with the documentation, that it is a – a licensed system.

If we don't do that, we lose the benefits of the injunction. The burden is not on them. It's on us. We lose the benefits of the injunction, if we can't prove it.

I object to that provision. I – I don't know why it is that we have to be the ones that make sure that they obey the law, but that's what the order says.

THE COURT: Well, because you've got the best access to the records. That's the reason.

MR. WALL: Well, that's – and that's clearly what Judge Smith felt, –

THE COURT: That seems –

MR. WALL: – and that's why we're under that obligation.

THE COURT: – that seems fairly straightforward to me.

[p. 51] MR. WALL: We did not cross-appeal from it. We're – we're – and, frankly, one of the reasons we didn't is because even though I don't think that that's something that, you know, maybe Dan Wall as a person thinks it should come – should be our responsibility, that it actually addresses this issue and clears it up.

So we're – we're actually better off to have this so that this – this incessant claim, which is so false, that they can't tell what these systems are, it now comes to an end.

It's our problem. We either prove it or we don't have the rights under the injunction. And – and sobeit. We'll live under those – under those rules.

Now the other thing that I want to say, though, is – is, if I may, this – this document here, which is just a – the exemplar of the – the license agreement that we use, this box here is where you list what the person is getting, the applications programs and so forth.

The – this operating system definition, which incidentally is a contract collective deposition – definition. It says that the person has licensed the operating system and utility software, and that is a defined term, as operating software under – under the contract.

That means that if the word "operating software" appears here, it's a licensed system. And that's what Judge Smith found. And that's what Judge – and that's why – and it's [p. 52] because that is so easy to do, notwithstanding what they say. You know, these computers cost fifty, sixty, seventy, sometimes a hundred thousand dollars. This agreement is like the pink slip to the car. The notion that the customers never had it or something like that is made up.

If – if they go to their customer and they say: Let me see this. I want to see if the word "operating system" appears there, it's over.

THE COURT: Isn't it going to appear in every contract?

MR. WALL: No, it will not, because if the operating –

THE COURT: Oh, because of the – you mean not the Regime I on it, yeah.

MR. WALL: The Regime I contract, the operating system will appear on a different agreement which says: System purchased, –

THE COURT: Yeah, I understand.

MR. WALL: – system purchase agreement.

THE COURT: Right. I understand.

And – and it would appear on every one of the later ones –

MR. WALL: In the –

THE COURT: – someplace.

MR. WALL: It's not repeated is the is the point there.

THE COURT: Um-hum.

MR. WALL: So if – if it is repeated, it's usually [p. 53] because the person has traded in their computer, an old computer, on a new computer. And you have the superseding contract.

These contract issues were dealt with by Judge Smith at extraordinary length, extraordinary length, over a series of – of motions. And these are the decisions that she made. And, frankly, they have not been appealed from.

All they're doing on this appeal is saying that it's too hard and, therefore, since – since the – I guess the argument is that since the – the truth is hard to find, we

should be able to live in a world contrary to the truth. I don't see any equity in that argument at all.

They are the ones who have chosen to build a business in an environment where they are dependent on this software. And until they build their own or come and get that license from us, there are going to be some problems. They're going to have to live with some things.

THE COURT: How practical is it – I suppose there's nothing in the record to answer this – to build their own and service it?

MR. WALL: Well, they say that it's not, but – but Judge Smith made a point to say that they never put any evidence in the record of that. It – it's actually not in her – in her findings, per se, but if you look at the transcript pages where she first announced her findings under fair use, she made the point that though claim has been made, it has never been [p. 54] substantiated.

And in a – and the fact of the matter is is that there other industries where independent service organizations have – have developed their own utilities. I represent a client that – that has developed its own utilities to compete – to compete for a competitor's service business. It can happen.

But if it can't, if they're – if they're not up to the task, they can get a license. They just won't do it. They will – they just will not come up to the plate on that.

I just have a couple minutes. I want to – I want to make a couple of points about this bifurcation issue.

THE COURT: Is that in the record that they can obtain a license?

MR. WALL: Yes.

THE COURT: It is?

MR. WALL: We put on trial testimony to that effect. And it's cited. We actually – there's a section of our brief –

THE COURT: It doesn't get to the issue of cost or price?

MR. WALL: Absolute – We can't negotiate with them.

THE COURT: You can't. All right.

MR. WALL: And, you know, we've actually put in evidence of what we thought we would charge. We said we would charge – we thought we would charge about seventy dollars per customer a month. They charge about two and fifty dollars for a [p. 55] – a contract per month. And the record showed they had plenty of margin if they add that extra seventy-dollar cost in there.

But, you know, they – they've got a terrific competitive advantage over us, as long as they can use our software without paying for it. It gives them a loaded cost structure. It's why those bootleg videotapes on Market Street only cost ten bucks when they cost fifty dollars at – at Blockbuster. You know, it's always cheaper to compete if you don't pay for the intellectual property rights that – that you're using.

The – the last point that I really want to make is about this issue of – of bifurcation. This issue is, for all intents and purposes, moot now.

They have said – and, Judge Sneed, I'm sure you'll remember this from the March 20 hearing. They told you that their principal defense was the misuse defense and that they didn't have a chance to – to present that defense before this injunction was issued. Well, –

THE COURT: Misuse and antitrust.

MR. WALL: Misuse and antitrust.

Well, misuse is a defense; antitrust is – as a counterclaim.

And what they said was that they never had a chance to present that. And that was a false statement that they made to you, because they moved for a preliminary injunction on their [p. 56] antitrust claims and they moved for summary judgment on the misuse defense.

And in her – in her decision back in March of 1994, Judge Smith held that they weren't going to prevail, that they were – they were not likely to prevail on the merits of the antitrust claims. And she held that their misuse argument was just deficient as a matter of law.

And the bifurcation order has to be understood in that context. She was relegating to the second phase claims which she had already determined did not have substantial merit.

And what was she – what she was concerned about and what she said during the trial, was that they were trying to use the pendency of those claims as a vehicle for putting the copyright system on trial. Because we know that the antitrust laws and the copyright laws and the intellectual property laws, generally, are somewhat at cross purposes.

One is all about promoting competition. The other creates a limited exemption from – from competition. And they wanted to be able to come in here and – and tell the jury: Don't enforce these copyrights because it would be anticompetitive.

And Judge Smith said she wasn't going to let them muddle the copyright issues by doing that. And – and the notion that that is an abuse of discretion for a – for a judge to want to prevent somebody from putting on a case against the copyright [p. 57] system, with a claim that she's already found it insubstantial, is again not tenable. But the final chapter in this occurred last month in between the time of the motions panel hearing and this hearing, when Judge Smith summarily adjudicated the – the misuse defense in our favor and against them.

So the copyright issues in this case are now fully adjudicated. And that leads to the bottom line of this whole thing, that the fundamental issue for the Court is whether it was an abuse of discretion to enjoin copyright infringement proven at trial and when the claim now – is now fully adjudicated. It – it can't possibly be so.

Most injunctions are – are based on a much more truncated record. This is based on Judge Smith's two and a half years of intensive involvement in this case. Her factual findings deserve to be respected. And her analysis of the fair use doctrine is dead on. And it could not be otherwise.

Thank you, Your Honors.

THE COURT: All right. Thank you, Mr. Wall.

Mr. Katz.

MR. KATZ: Thank you, Your Honors.

I think it's a tribute to Mr. Wall's lawyer – lawyering abilities that he can make a case that is truly absurd seem like it makes some sense. This is truly an absurd case. The idea that you would turn on a computer for the purpose of maintaining it for someone who rightfully possesses software and [p. 58] the hardware, and that would be considered to be a copyright infringement.

He says that this is like – like videotapes on Market Street. That is not what we are saying here. We're not saying that Microsoft's copyrights are invaluable. We're not saying that software should not be copyrightable.

We're saying people should not be able to come in and copy Microsoft's software and proliferate it and sell it. That's the purpose of the copyright laws. But we are saying that someone can intermediately copy something for a legitimate purpose.

And no one in the world, not even Mr. Wall, thought that that was an infringement before MAI. And MAI has been a very, very heavily criticized case, just to read from the *University of Washington Law Review, 69 Law Review* 405, the MAI Systems Court reached a flawed decision lacking any cogent rationale or supporting public policy.

The Court's cursory dismissal of Section 117's applicability based upon its interpretation of owner inappropriately restricts rights that computer users have long taken for granted and fails to consider the practical effects on the computer industry. That's round squares – round pegs into square holes. That's the problem.

THE COURT: Now as I recall, the Supreme Court didn't dismiss – didn't deny certiorari. They settled it.

[p. 59] MR. KATZ: The case was settled. The case was settled.

THE COURT: Settled, on that basis that –

MR. KATZ: The case was settled.

The – on the licensing issue, I would simply refer you to our papers, our opening brief at page 7. There is no evidence that this ever was licensed.

And as Your Honors have questioned: Why would you get a license from your competitor? One week it could be ten dollars, the next week it could be a thousand dollars. No one would ever go into that business.

The idea that we would have to create an operating system in order to be a maintenance company has been rejected by the Supreme Court in the Kodak case as matter of law, where they said that as a matter of law the purpose of the antitrust laws is such that you don't have to enter two markets in order to compete in one of them.

He – he talks about turning on utilities and – as if that was proved. Please keep in mind there is not a single instance of proof in this case that we ever turned on anything that was copyrighted. None, zero. It was all done from statistics. It was all based on these contracts that they had.

They were not given the burden of proof as they should have. They should have brought these there for their own burden of proof. Having not brought them

there for their burden of proof, they certainly should have been produced under 1006, which [p. 60] is mandatory. They were not. So we had the double whammie of having the burden of proof and not being able to get the evidence, the only evidence that would prove this. They had sold this stuff for fourteen years. Fourteen years.

THE COURT: Well, this is a preliminary injunction. Maybe when you get back you can – you can all agree on what contracts are what.

MR. KATZ: Well, I think that if Your Honors decide the fair-use question in accord with Sega, as I think you should, that we may not have to be back.

THE COURT: Well, that's very true. Of course.

MR. KATZ: And that's what I'm hoping, because when Mr. Frederick writes his next book, I hope he's writing about Sega or certainly this case – this case. The –

THE COURT: Well, I – just making an observation about this whole matter. This area is in a state of transition, I'm convinced. I don't know where it's going. I have no idea. But there are problems here. And I can see in part your side of the argument. But we're pretty well stuck with MAI. And there we are.

MR. KATZ: Well, I don't think that MAI has any higher authority –

THE COURT: Well, I know – I know you don't.

MR. KATZ: – than Sega. If I may just finish by reading what I think is the dispositive portion of Sega on page [p. 61] 1527:

> As discussed above, the fact that computer programs are distributed for public use in object code form often precludes public access to the ideas and functional concepts contained in those programs, and thus confers on the copyright owner a de facto monopoly over those ideas and functional concepts.

That result defeats the fundamental purpose of the Copyright Act, to encourage the production of original works by protecting the express developments of those works while leaving the ideas, facts and functional concepts in the public domain for others to build on.

I think that MAI should be completed. I think that this panel should complete the work that the MAI panel started. Without a fair-use analysis, the MAI decision is simply a work in progress. It must be completed and it must be completed under the philosophy and the holdings of Sega.

Thank you very much.

THE COURT: Thank you, Mr. Katz.

Thank you, counsel.

The case just argued is ordered submitted for decision –

(End of recording.)

State of California)
) SS.
County of Santa Cruz)

I, Susan Palmer, certify that the foregoing is a true and correct transcript, to the best of my ability, of the above pages, of the audio cassette copy recording provided to me by the law firm McCutchen, Doyle, Brown & Enersen, of the proceedings in the above matter.

I further certify that I am neither counsel for, related to, nor employed by any of the parties to the action in which this administrative hearing was taken, and further that I am not financially or otherwise interested in the outcome of the action.

/s/ Susan Palmer

Susan Palmer
Palmer Reporting Services

Dated December 31, 1995

State of California)
) SS.
County of Santa Cruz)

I, Steven Palmer, certify that the foregoing is a true and correct transcript, to the best of my ability, of the above pages, of the electronic sound recording provided to me by the United States District Court, Northern District of California, of the proceedings taken on the date and time previously stated in the above matter.

I further certify that I am neither counsel for, related to, nor employed by any of the parties to the action in

which this administrative hearing was taken, and further that I am not financially or otherwise interested in the outcome of the action.

/s/ Steven Palmer

Steven Palmer
Palmer Reporting Services

Dated January 1, 1996